The U.S.' Handling of Tax Secrecy: Anti-Evasion Measures

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Publication date:
2020

Document Version
Publisher's PDF, also known as Version of record

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ANTI-AVOIDANCE MEASURES

BY
KRISTEN SUE CHRISTIANSEN

DISSERTATION SUBMITTED 2020

AALBORG UNIVERSITY
DENMARK

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Dissertation submitted

.

Dissertation submitted: May 31, 2020

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PhD Series: Faculty of Social Sciences, Aalborg University

ISSN (online): 2246-1256
ISBN (online): 978-87-7210-457-7

Published by:
Aalborg University Press
Langagervej 2
DK – 9220 Aalborg Ø
Phone: +45 99407140
aauf@forlag.aau.dk
forlag.aau.dk

Cover Photo: Jan Brødslev Olsen

Printed in Denmark by Rosendahls, 2020

Standard pages: 379 pages (2,400 characters incl. spaces).

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ENGLISH SUMMARY

For decades, obtaining information on U.S. taxpayers' foreign accounts in order for the U.S. tax authority to administer the domestic tax laws correctly and fairly has been difficult due to the obstacle that secrecy presents.

The U.S. domestic tax system depends on both taxpayer and third-party reporting to verify accurate tax filings. However, when the taxpayer has foreign accounts this becomes more difficult for the U.S. government via the Internal Revenue Service to verify the accuracy of the filing and to have access to all of the information that should be part of the filing. The U.S. government has multiple measures that together create an anti-tax evasion framework that allows them to procure information on the foreign accounts held by U.S. taxpayers.

This dissertation aims to examine four questions in relation the measures the U.S. government has taken to identify and procure information on U.S. taxpayers' foreign accounts. First, what measures are being taken by the U.S. government to procure U.S. taxpayer information on foreign financial accounts despite bank secrecy laws that prohibit the IRS from administering the U.S. tax laws correctly and fairly? Second, how are these measures implemented in order to address the inability to procure information on U.S. taxpayers' foreign financial accounts? Third, do the measures, when administered, enable the IRS to obtain formerly inaccessible taxpayer information so that the IRS has all the facts to administer the U.S. tax laws correctly and fairly? If the answer to the third question is found to be in the negative, then a fourth question presents itself. If the measures do not permit the IRS to procure the information they need on U.S. taxpayers' foreign financial accounts, what can be done to improve the measures, so it increases the IRS' chances of obtaining the information?

Based on a review of the literature that evaluates and discusses the U.S.' anti-tax evasion measures, a review of all applicable U.S. legal resources that are connected

with these various anti-tax evasion measures - including but not limited to, statutes, case law, legislative history, and regulations - were analyzed. This analysis found that each of the anti-tax evasion measures had flaws that did not allow for the U.S. government to procure U.S. taxpayer information on foreign accounts.

The results indicate that the anti-tax evasion measures as stand-alone efforts do not procure the information on U.S. taxpayers' foreign financial accounts that is needed. However, using the measures in concert with each other as an overall anti-tax evasion framework – or coordinated federal attack – should be the strategy the U.S. continues to use to procure the information on U.S. taxpayers' foreign accounts so that the IRS can administer the tax laws correctly and fairly.

DANSK RESUME

I årtier har det været vanskeligt at få information om amerikanske skattebetalers udenlandske konti for at den amerikanske skattemyndighed kan administrere de nationale skattelovgivninger korrekt og retfærdigt på grund af den hindring, som hemmeligholdelse udgør.

Det amerikanske indenlandske skattesystem afhænger af både skatteyderens og tredjeparts rapportering for at verificere nøjagtige skatteangivelser. Når skatteyderen har udenlandske konti, bliver dette imidlertid vanskeligere for den amerikanske regering via Internal Revenue Service at verificere indleveringens nøjagtighed og få adgang til alle de oplysninger, der skal være en del af indleveringen. Den amerikanske regering har flere foranstaltninger, der tilsammen skaber en ramme mod skatteunddragelse, der giver dem mulighed for at skaffe information om de udenlandske konti, som amerikanske skatteydere har.

Denne afhandling har til formål at undersøge fire spørgsmål i relation til de foranstaltninger, den amerikanske regering har truffet for at identificere og skaffe information om amerikanske skatteyderes udenlandske konti. For det første, hvilke skridt der træffes af den amerikanske regering for at skaffe amerikanske skatteyderoplysninger om udenlandske finansielle konti til trods for bankhemmelighedslove, der forbyder IRS at administrere de amerikanske skattelove korrekt og retfærdigt? For det andet, hvordan gennemføres disse foranstaltninger for at tackle manglende evne til at skaffe information om amerikanske skattebetalers udenlandske finansielle konti? For det tredje, gør foranstaltningerne, når de administreres, IRS i stand til at indhente tidligere utilgængelige oplysninger om skatteyderne, så IRS har alle fakta til at administrere de amerikanske skattelovgivninger korrekt og retfærdigt? Hvis svaret på det tredje spørgsmål viser sig at være negativt, præsenterer et fjerde spørgsmål sig. Hvis foranstaltningerne ikke tillader IRS at skaffe de oplysninger, de har brug for på amerikanske skatteyders

udenlandske finansielle konti, hvad kan der gøres for at forbedre foranstaltningerne, så det øger IRS 'chancer for at indhente oplysningerne?

Baseret på en gennemgang af litteraturen, der evaluerer og diskuterer USAs anti-skatteunddragelsesforanstaltninger, en gennemgang af alle gældende amerikanske juridiske ressourcer, der er forbundet med disse forskellige skatteunddragelsesforanstaltninger - herunder, men ikke begrænset til, vedtægter, retspraksis , lovgivningsmæssig historie og reguleringer - blev analyseret. Denne analyse fandt, at hver af de anti-skatteunddragelsesforanstaltninger havde mangler, der ikke gjorde det muligt for den amerikanske regering at skaffe amerikanske skatteyderoplysninger om udenlandske konti.

Resultaterne indikerer, at foranstaltningerne til bekæmpelse af skatteunddragelse som selvstændig indsats ikke skaffer de nødvendige oplysninger om amerikanske skattebetalers udenlandske finansielle konti. Imidlertid bør anvendelse af foranstaltningerne i samarbejde med hinanden som en samlet ramme mod skatteunddragelse - eller koordineret føderalt angreb - være den strategi, som USA fortsætter med at bruge til at skaffe oplysningerne om amerikanske skattebetalers udenlandske konti, så IRS kan administrere skatteregler korrekt og retfærdigt.

ACKNOWLEDGEMENTS

The focus of this dissertation is on the measures the U.S. government uses to procure information on U.S. taxpayers' foreign accounts so that the tax laws may be administered correctly and fairly. One might wonder why a PhD being written at a Danish University is about U.S. law. SKAT, Denmark's Tax Authority, funded this PhD in conjunction with a larger project on tax evasion. Thank you to SKAT for the funding and the chance that gave me the ability to look deeper into U.S. tax law and write a PhD about it.

Throughout the writing of this thesis, I have received support and assistance in many forms. First, I would like to thank my supervisors, Thomas Neumann and Anders Nørgaard Laursen. This project has had many obstacles, and both were invaluable in helping me to overcome those obstacles. Thomas was an immense help both methodologically and structurally and, in the form of a great supervisor, he almost never answered my questions directly but instead let me work out the problem many times for myself while talking through it with me. Anders came late into the project, but his knowledge and invaluable insight has allowed me to formulate a solid research topic in the area of U.S. tax law. Anders, this project would never have been what it is without you. I am truly grateful.

I would like to acknowledge the Uppsala University's Center for Tax Law which sponsored a trip so that I could give a presentation on my thesis and gain constructive feedback on both the topic and methodology. Thank you specifically to Bertil Wiman, Professor of Finance Law at Uppsala, for his knowledge and expertise. Another big thank you to Katia Cejie, who I met at a methodology course on a *very* wintery Ystad, Sweden day. Thank you, Katia, for taking me under your wing for a bit and inviting me to Uppsala. I am grateful for it (and for helping to save my project!) and for your friendship. Hopefully the summer will not be too hot this year!

Thank you to my wonderful mother-in-law, Mona, and Erik, who both supported me in a variety of ways including taking care of Sofie and loaning me a beach house for a week so that I could have a quiet place to write. I love you both and am grateful to have you in my life.

Thank you to my Mom, who has listened to me vent from what seems a million miles away sometimes and who was incredibly supportive of me working while she was here for a visit and helped with Sofie. I love you mom. Grams and Gramps are so proud of you and I would not be the woman or mother I am without you.

Thank you to my Dad and Bonus Mom Kathy, who are both U.S. lawyers and frequently took panicked, frustrated or regular phone calls with questions about U.S. law. My dad also reviewed and edited some of my writing. I could not have done this without you two. I love you both.

To my grandparents, Hazel, Violet and Otto, who are no longer with us. Thank you for the lessons you taught me (never giving up), the work ethic and the stubbornness you instilled in me. The world was a little brighter with you all in it. I wish you were here to see this.

I also want to acknowledge my Lord and Savior, Jesus Christ, without whom I would not be here nor have had the many opportunities I have had.

Finally, to my husband Claes who I met in the dusty, hot desert of Afghanistan and to our daughter Sofie Catherine. You two have sacrificed a lot while allowing me the time and space to finish this thesis. Sofie Catherine, you are the world's best daughter and I know you will do amazing things! I love you unconditionally. Claes, we have come a long way from Afghanistan, and I am so grateful for the unconditional support you have given me during this long and frustrating process. It was not easy, but you stood by me and pushed me when I needed to be pushed and gave me space when I needed space. I love you always and forever.

To Effie and Josephine – women who did not have the chances I did but who were courageous in their own time. To Dee, we miss you and love you so much. This is for you three amazing women.

ABBREVIATIONS & TERMINOLOGY

AML	Anti-Money Laundering
AUP	Agreed Upon Process
BSA	Bank Secrecy Act
CCA	Chief Counsel Advice
CFR	Code of Federal Regulation
DOJ	Department of Justice
EIN	Employer Identification Number
GAO	General Accounting Office
FATCA	Foreign Account Tax Compliance Act
FBAR	Report of Foreign Bank and Financial Accounts
FDAP	Fixed, Determinable, Annual or Periodic Income
FFI	Foreign Financial Institution
FI	Financial Institution
FinCEN	(U.S.) Financial Crimes Enforcement Network
HIRE	Hiring Incentives to Restore Employment Act (2010)
H.R.	House of Representatives
IGA	Intergovernmental Agreements
IRC	Internal Revenue Code (Chapter 26 of the United States Code)
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
JCT	Joint Committee on Taxation

KYC	Know Your Customer
MLAT	Mutual Legal Assistance Treaty
NFFE	Non-Financial Foreign Entity
NQI	Non-Qualified Intermediary
NRA	Non-Resident Alien
NWQI	Non-Withholding Qualified Intermediary
OCCP	Offshore Credit Card Program
OVCI	Offshore Voluntary Compliance Initiative
OVDP	Offshore Voluntary Disclosure Program
P-FFI	Participating FFI
QI	Qualified Intermediary
RFI	Reporting Financial Institution
R.O.	Responsible Officer
S.	Senate
TIEA	Tax Exchange Information Agreement
TIN	Tax Information Number
USC	United States Code
USWA	United States Withholding Agent
U.S.	United States
WQI	Withholding Qualified Intermediary

TABLE OF CONTENTS

CHAPTER 1. INTRODUCTION

1.1. THE SUBJECT

It has been said that the two things that are guaranteed in life are death and taxes. Instead, three things are certain in one's life: "*death, taxes and mankind's unrelenting effort to evade taxes*."[1] Tax evasion has been the focus of the United States (hereinafter U.S.) legislation, congressional hearings, academic research and scrutiny by the media (society) for over a century. Congressional hearings have provided legislators both evidence and confirmation that tax evasion is an immense problem.[2] In 2003, even before the 2007-2008 bank scandals, the estimate of assets held in U.S. taxpayer-owned accounts at UBS, a Swiss-based financial services company, was between $18-20 billion.[3] The compliance numbers that have been reported for the Report of Foreign Bank and Financial Accounts (FBAR) alone demonstrate the problem: five to seven million U.S. resident taxpayers and tens of millions of non-resident taxpayers are subject to the FBAR filing requirements yet in 2011 only 741,000 of those subject to the FBAR complied.[4] It was estimated in 2015 that 8.7 million Americans live abroad and yet just over. 1.5 million file tax returns with the

[1] Steven Klepper & Daniel Nagin, *The Anatomy of Tax Evasion*, 5 J. L. Econ. & Org. 1 (1989).
[2] U.S. Senate Permanent Subcommittee on Investigations, Homeland Sec. & Governmental Affairs Permanent Subcommittee on Investigations, *Offshore Tax Evasions: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts* (2008); *See also*, U.S. Senate Permanent Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance*, Committee on Homeland Security and Governmental Affairs Staff Report, 19 (July 2008); United States Permanent Subcommittee on Investigations, *What is the U.S. Position on Offshore Tax Havens?*, Senate Hearing No. 107-152 (July 18, 2001); U.S. House Committee on Ways and Means, *Hearing on Banking Secrecy Practices and Wealthy American Taxpayers*, No. 111-12 (March 31, 2009); U.S. House Committee on Ways and Means, Subcommittee on Select Revenue Measures, *Foreign Bank Account Reporting and Tax Compliance*, No. 111-35 (November 5, 2009); U.S. Senate Committee on Finance, *Offshore Tax Evasion: Stashing Cash Overseas*, S. Hrg. 110-677 (May 3, 2007).
[3] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014).
[4] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 380 (Palgrave MacMillan 2016).

Internal Revenue Service (IRS).[5] The U.S. domestic tax system depends on both taxpayer and third-party reporting to authenticate whether tax filings are accurate or not. However, when the U.S. taxpayer has foreign accounts the ability to authenticate the information becomes more difficult for the U.S. government. The IRS only has the information that the taxpayer provides them which may or may not be all of the information that is pertinent to the foreign account. For the IRS to be able to administer the law correctly and fairly[6] they need to have access to all of the information that should be part of the filing. The fact that foreign third parties are not required to report to the U.S. government on the U.S. taxpayers' accounts only compounds the problem because then the IRS has no way to verify if the information the taxpayer is providing is reliable. This dissertation will analyze a very narrow part of a very broad topic with in tax law that is highly problematic[7]: How the U.S. government procures U.S. taxpayer information on foreign accounts in order to administer the tax law correctly and fairly despite obstacles such as secrecy laws that allow U.S. taxpayers to conceal their foreign accounts. The U.S. government has multiple measures that when they work together create an anti-tax evasion framework that allows the government to procure information on the foreign accounts held by U.S. taxpayers. Despite having multiple measures that comprise the anti-tax evasion framework which would seem to lack coherence, it is not the framework itself that poses the issue but the evolving nature of secrecy and how it is used to conceal taxpayers' foreign accounts. The multiple measures examined in this thesis are the U.S. government's coordinated (and sometimes uncoordinated) assault on secrecy which is an effective approach when the U.S. cannot obtain the information needed to

[5] Charles P. Rettig, *Why the Ongoing Problem with FBAR Compliance*, J. Tax & Proc. 37, 39 (August/September 2016)

[6] The concepts of correctly and fairly simply means – within the context of this thesis – is that the IRS will apply the right tax laws to the taxpayer's situation given that they have all the facts and that how they apply those tax laws is not different from one taxpayer to the next (again given they have all the facts regarding the taxpayer's situation).

[7] U.S. Senate Permanent Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance*, Committee on Homeland Security and Governmental Affairs Staff Report, 19 (July 2008); *See also*, United States Permanent Subcommittee on Investigations, *What is the U.S. Position on Offshore Tax Havens?*, Senate Hearing No. 107-152 (July 18, 2001); U.S. Senate Permanent Subcommittee on Investigations, *Crime and Secrecy: The Use of Offshore Banks and Companies*, (U.S. Government Printing Office, 1983).

administer the laws correctly and fairly. This is particularly important when secrecy is constantly changing the rules of the game.

Within the broad area of tax evasion are two almost equally broad topics and areas of academic research: tax transparency and tax havens.[8] While this thesis may fall under the broader issue of tax transparency – for example, tax transparency between two governments and tax transparency from the taxpayer to the Internal Revenue Service (IRS) – that wider issue is not the focus of this dissertation. Tax havens is the second area that falls under tax evasion that is related to the topic of this thesis because it has been a distraction to both politicians and society at large. Tax havens have had

[8] Tracy Kaye, *Tax Transparency: A Tale of Two Countries*, 39 Fordham Int'l L.J. 1153 (2016); *See also*, Anna-Marie Hambre, *Tax Confidentiality: A Comparative Study and Impact Assessment of Global Interest*, Örebro Studies in Law (2015); Joshua D. Blank, *The Timing of Tax Transparency*, 90 S. Cal. L. Rev. 449 (2017); See the list of National Reports on Tax Transparency from the 2018 European Association of Tax Law Professors (EATLP) Congress, *found at* http://www.eatlp.org/congresses/310-national-reports-2018; Joseph M. Erwin & Fred M. Murray, International Fiscal Association (IFA) Branch Report: United States (2013); Xavier Oberson, *International Fiscal Association General Report* (2013); International Fiscal Association, *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779 (2013).

numerous studies and research articles written on it.[9] While an important topic, there is a more pressing issue when trying to solve the problem of procuring U.S. taxpayer information on foreign accounts. That pressing issue is bank secrecy. Bank secrecy prohibits the IRS from obtaining taxpayer information so that it has all the relevant facts in order to administer the tax laws correctly and fairly.

Take Taxpayer Maverick for example. Taxpayer Maverick, a U.S. taxpayer[10], holds accounts in foreign jurisdiction X. Jurisdiction X has a reputation for and a history of bank secrecy. The IRS suspects that taxpayer Maverick has fraudulently filled out his tax return by not disclosing his foreign accounts. The U.S. tax system is based on voluntary disclosure by taxpayers of assets both domestic and foreign income and accounts with domestic third-party reporting as a fail-safe. Since Taxpayer Maverick

[9] Nicholas Shaxson, *How to Crack Down on Tax Havens*, Foreign Affairs, Feb. 13, 2018; *See also*, Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 Oxford Rev. Econ. Pol'y 661 (Oct. 2008); Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 402 (Autumn 2013); Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U.L. Rev. 337, 343 (January 2014); Tulio Rosembuj, *Harmful Tax Competition*, 27 Intertax 316, 328 (1999); Tyler J. Winkleman, *Automatic Information Exchange as a Multilateral Solution to Tax Havens*, 22 Ind. Int'l & Comp. L. Rev. 193,197 (2012); Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 Ind. J. Global & Legal Stud. 703, 705-706 (Summer 2009); Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8 (Penguin Random House, 2016); Myla Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32 Intertax 95 (2004); Dharmapala, D. and J. R. Hines, Jr. (2006) "*Which Countries Become Tax Havens?"* NBER Working Paper #12802; James R. Hines Jr., *Do Tax Havens Flourish?*, 19 Tax Pol'y & Econ. 65, 77 (2005); GAO, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008); GAO, *International Taxation: Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting*, GAO-04-856 (June 2004); Katrin Eggenberger, *When is Blacklisting Effective?: Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483 (2018); Clemens Fuest, *Tax Havens: Shady Deals*, 67 The World Today 16 (July 2011); Tracy A. Kaye, *Innovations in the War on Havens*, 2014 BYU L. Rev. 363 (2014); Jeffery Kraft, *Changing Tides: Tax Haven Reform and the Changing Views of Transnational Capital Flow Regulation and the Role of States in a Globalized World*, 21 Indiana J. Global Legal Stud. 599 (Summer 2014); Robert T. Kudrle and Lorraine Eden, *The Campaign Against Tax Havens: Will It Last? Will It Work?*, 9 Stan. J. L. Bus. & Fin. 37 (Autumn 2003); Alan S. Lederman and Bobbe Hirsh, *The American Assault on Tax Havens- Status Report*, 44 Int'l Law 1141 (Winter 2010).

[10] U.S. taxpayers in this thesis is meant as any person that owes U.S. tax, whether a U.S. person, natural and legal, a foreigner who owes tax on a U.S.-source payment (also called a NRA, non-resident alien.)

has potentially not disclosed his foreign assets and foreign third parties have no duty to disclose what actions can the IRS take to procure information on Taxpayer Maverick's foreign accounts? The IRS cannot administer the tax laws when it does not hold all the facts it needs so that it may do so fairly and correctly. The facts include all the taxpayer information (see subsection 1.4.2) that are relevant to the taxpayer's case. If the taxpayer does not voluntarily disclose or a foreign third-party refuses to disclose due to bank secrecy (among other reasons), the IRS is blinded to a portion of the facts it needs to administer the tax law. This has been an ongoing problem for decades as illustrated by the statement of Commissioner of the IRS in a 1983 congressional hearing on crime and secrecy. "*By far the most pressing problem, however, is the lack of accessibility to information or perhaps I should say lack of accessibility. The problem here is not so much one of substantive tax law but of getting the information to carry out the enforcement activities.*"[11] In response to this inability to procure taxpayer information – either through the taxpayer himself or through foreign third-parties – the U.S. has multiple anti-tax evasion measures that are utilized in an attempt to pierce the veil of secrecy and obtain taxpayer information on U.S. taxpayers' foreign accounts.

The Panama and Paradise Papers[12] have demonstrated that the problem of bank secrecy and lack of taxpayer compliance persists, grows even. This news has garnered attention from the U.S. government which has found that this problem is a global issue

[11] U.S. Senate Permanent Subcommittee on Investigations, *Crime and Secrecy: The Use of Offshore Banks and Companies (U.S. Government Printing Office, 1983).*

[12] The Panama and Paradise papers were two cases of millions of leaked documents that were published by the International Consortium of Investigative Journalists (see www.icij.org). These leaked documents included confidential electronic documents that described offshore investments and contained personal financial information on wealthy people as well as public officials from numerous countries.

with billions of dollars of tax revenue at stake.[13] Various estimates show that, globally, the annual tax revenue loss is, at the high end, $500 billion USD, and at the lower end, between $100 to 240 billion.[14] In the United States, the amount of unreported international income was around $100 billion in tax revenue annually[15], and the total

[13] International Consortium of Investigative Journalists, *Congress Members Call for Action in US After Paradise Papers, found at* https://www.icij.org/investigations/paradise-papers/congress-members-call-for-action-in-us-after-paradise-papers/; *See also*, NBC News, *IRS Urges Americans to Come Clean Now, found at* https://www.nbcnews.com/storyline/panama-papers/irs-urges-americans-come-clean-now-we-read-panama-papers-n557246 ; Foreign Policy, *The White House Cracks Down on Offshore Accounts*, https://foreignpolicy.com/2016/05/06/white-house-cracks-down-on-offshore-accounts/; United States House, *White House, Doggett Call for Action on Tax Haven Bill in Wake of Paradise Papers, found at* https://doggett.house.gov/media-center/press-releases/whitehouse-doggett-call-action-tax-haven-bill-wake-paradise-papers; Miami Herald, *Senator Wants IRS to Show What It's Done About Tax Fraud Since Panama Papers Reports, found at* https://www.miamiherald.com/news/nation-world/national/article109259467.html; United States Department of Justice, *Four Defendants Charged in Panama Papers Investigation for Their Roles in Panamanian-Based Global Law Firm's Decades-Long Scheme to Defraud the United States, found at* https://www.justice.gov/opa/pr/four-defendants-charged-panama-papers-investigation-their-roles-panamanian-based-global-law

[14] Tax Justice, *Estimating Tax Avoidance Questions*, https://www.taxjustice.net/2017/03/22/estimating-tax-avoidance-questions/; *See also*, OECD, *Governments Rapidly Dismantling Harmful Tax Incentives Worldwide*, http://www.oecd.org/ctp/beps/governments-rapidly-dismantling-harmful-tax-incentives-worldwide-beps-project-driving-major-changes-to-international-tax-rules.htm; Forbes, *Tax Avoidance Costs the U.S. Nearly 200 Billion Every Year*, https://www.forbes.com/sites/niallmccarthy/2017/03/23/tax-avoidance-costs-the-u-s-nearly-200-billion-every-year-infographic/

[15] U.S. Senate Permanent Subcommittee on Investigations, *Offshore Tax Evasions: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts*, Homeland Sec. & Governmental Affairs Permanent Subcommittee on Investigations (2008), *available at* http://hsgac.senate.gov/subcommittees/investigations/hearings/offshore-tax-evasion-the-effort-to-collect-unpaid-taxes-on-billions-in-hidden-offshore-accounts ; *see also*, Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism*, 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015)*;* U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland,* 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013).

tax gap – the total amount of U.S. taxpayers' tax liability not paid on time – is estimated to be $458 billion.[16]

As discussed in Chapter 3, one method used by the U.S. and other nations to address the problem of secrecy and the inability to procure taxpayer information was assessing whether a jurisdiction was a tax haven either through drafting a blacklist of jurisdictions alleged to be tax havens or devising a substantive list of characteristics that defined what a tax haven looked like.[17] These methods were used by multiple jurisdictions including supranational entities such as the European Union (EU) and the Organization for Economic Co-operation and Development (OECD) and even individual U.S. states.[18] While the United States has had unofficial blacklists, a blacklist or definition has never been enacted into American legislation or used in any

[16] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014); See also, Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 291-292 (Spring 2013); Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance,* 18 Chapman L. Rev. 243 (2014); James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 989 (2016-2017).

[17] Nicholas Shaxson, *How to Crack Down on Tax Havens,* Foreign Affairs, Feb. 13, 2018; *See also*, Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 Oxford Rev. Econ. Pol'y 661 (Oct. 2008); Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 402 (Autumn 2013); Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U.L. Rev. 337, 343 (January 2014); Tulio Rosembuj, *Harmful Tax Competition*, 27 Intertax 316, 328 (1999); Tyler J. Winkleman, *Automatic Information Exchange as a Multilateral Solution to Tax Havens*, 22 Ind. Int'l & Comp. L. Rev. 193,197 (2012); Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 Ind. J. Global & Legal Stud. 703, 705-706 (Summer 2009); Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8 (Penguin Random House, 2016); Myla Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32 Intertax 95 (2004); Dharmapala, D. and J. R. Hines, Jr. (2006) "*Which Countries Become Tax Havens?"* NBER Working Paper #12802; James R. Hines Jr., *Do Tax Havens Flourish?*, 19 Tax Pol'y & Econ. 65, 77 (2005).

[18] OECD, *Tax Havens: Summary of the Findings of the First Study of International Tax Avoidance and Evasion: Four Related Studies*, 15 Intertax 122 (Paris 1987); *See also*, Organization for Economic Co-operation and Development (OECD), *Harmful Tax Competition: An Emerging Global Issue*, at 22, OECD Report (1998); Commission Staff Working Document Impact Assessment, at 117, COM (2012) SWD 404 final (2012) citing Janelle Gravelle's article.

official capacity to identify tax havens within the taxation system. These definition attempts by various jurisdictions have not been successful, and so the governments have had to find other measures to deal with tax evasion. The reason that the attempts have not been successful is because there are not real consequences, generally, for being listed and the listing of a jurisdiction on a blacklist is relative. For example, Switzerland has a solid reputation as a tax haven due to its secrecy laws, however, it rarely shows up on such lists. For example, the EU list never named Switzerland as a tax haven.

This issue on drafting definitions and blacklists diverts attention from the real issue that presents obstacles in procuring taxpayer information: secrecy. When examining the problem of tax evasion from a big picture perspective, the root problem is not the alleged tax haven itself but the secrecy that the jurisdiction provides. The attempts at defining tax havens and drafting blacklists that have been used to address the issues of tax evasion and tax havens have missed the mark widely, and even now, some countries are considering or have recently passed a blacklist identifying tax havens. The U.S. government seems to have acknowledged that secrecy – the main obstacle to procuring U.S. taxpayer information on foreign accounts – cannot be solved through blacklists or definitions and, instead, chooses to use several anti-tax evasion measures which creates a larger anti-tax evasion framework that targets the secrecy.

1.2. AIM OF THE STUDY

The U.S. government has struggled to address the inability to obtain taxpayer information on foreign accounts so that the IRS can administer the laws fairly and correctly. While the U.S. has used general anti-avoidance (GAARs) and special anti-avoidance rules (SAARs) to target companies and individuals that utilize tax haven jurisdictions, there are also measures that are used to address the problem of obtaining taxpayer information on foreign accounts that has confronted the IRS. There are multiple, legitimate reasons that a taxpayer may have for not disclosing to the tax authority – for example, they may not know they have to. However, many taxpayers

do know they are required to disclose their foreign accounts, and instead, choose to utilize the foreign jurisdiction's secrecy to conceal their accounts.

The issue of secrecy and how it was used to obscure American-held accounts culminated in 2007 when Bradley Birkenfeld blew the whistle on his former employer, UBS.[19] This was followed by the subsequent 2009 deferred prosecution agreement between the U.S. government and UBS that contained a penalty of $780 million fine.[20] While the U.S. has the GAARs and SAARs to target tax evasion, the UBS case demonstrated that the laws and regulations failed, not only because they were flawed, but also because the IRS did not have access to the information they needed to administer the tax laws correctly and fairly which has allowed thousands of U.S. taxpayers to conceal foreign accounts and evade billions in tax revenue. As will be demonstrated throughout the thesis, the UBS scandal was a catalyst for much of the battle against secrecy post-2007 and it affected many of the anti-tax evasion measures either through tightening the existing measures or by creating a new measure to address the problems found in the other anti-tax evasion measures.

The United States, domestically, has a system in place that allows for taxpayers and employers as well as financial institutions (in some situations) to report income and account information to the IRS. The problem that occurs is when the IRS cannot

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[19] Matthew Beddingfield and Colleen Murphy, *The UBS Whistle-Blower Who Won't Back* Down, Bloomberg News (April 3, 2017), *found at*, https://www.bna.com/ubs-whistleblower-wont-n57982086148/; Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013); *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015); James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 985 (2016-2017).

[20] Matthew Beddingfield and Colleen Murphy, *The UBS Whistle-Blower Who Won't Back* Down, Bloomberg News (April 3, 2017), *found at*, https://www.bna.com/ubs-whistleblower-wont-n57982086148/; Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013); *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015); James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 985 (2016-2017).

procure information on U.S. taxpayers' foreign accounts due to secrecy or strong privacy laws because foreign financial institutions and employers are not obligated to report to the IRS. The IRS cannot determine the correct amount of tax liability or administer any number of tax laws (benefits, withholding, etc.) because they do not have all the facts – the information on foreign accounts – in front of them.

This dissertation fills a void concerning in-depth research on the U.S.' response to the inability of the U.S. government to procure taxpayer information – mainly due to bank secrecy – so that the IRS can fairly and correctly administer the tax laws to each taxpayer's situation. There are articles[21] that have been written that address – not to the depth explored here - most of the measures discussed in this thesis. But those articles generally refer very briefly to several of the measures are used in tax compliance before moving on to the Foreign Account Tax Compliance Act (FATCA) which is the focus of those articles.

Many of the articles, however, address only one or two of the measures individually instead of examining the measures together as the U.S. government's anti-tax evasion framework that allows the government to obtain information on U.S. taxpayers' foreign accounts.[22] For instance, Megan Brackney and Cecelia Kehoe Dempsey focus

[21] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015); *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, (Palgrave MacMillan 2016); Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 101 (October 2013); Joanna Heiberg, *FATCA: Toward a Multilateral Automatic Information Reporting Regime*, 69 Wash. & Lee L. Rev. 1685 (2012).

[22] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 9 (Palgrave MacMillan 2013); *See also*, Frederick Behrens, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 Wis. L. Rev. 205 (2013); Reuven S. Avi-Yonah and Martin B. Tittle, *The New United States Model Income Tax Convention*, 61 Bulletin Int'l Tax'n 224 (2007); Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29 (Fall 2017); Stephan Michael Brown, *One Size Fits Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243 (2014); William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-4 (March 1st, 2017); Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory*

on the John Doe summons and its purpose and how it is carried out.[23] Stephan Michael Brown's article examines both the FBAR (Chapter 4) and voluntary disclosures (Chapter 5).[24] A few articles, and even a book, address multiple measures, but these articles – like Bruce Bean and Abbey Wright's article – focus on these measures as pre-FATCA measures instead of examining these measures as the IRS' cumulative approach – or anti-tax evasion framework – to obtaining taxpayer information on foreign accounts.[25] This thesis argues that while many of the measures were enacted before FATCA, they are certainly still valid and work in concert together with FATCA – as an anti-tax evasion framework – to procure taxpayer information on foreign accounts via taxpayers and third parties such as foreign financial institutions and foreign governments.

Ross K. McGill has written an insightful and comprehensible book that is focused on the U.S. tax withholding system which is comprised of two of the measures discussed in this thesis: the Qualified Intermediary Program (Chapter 7) and FATCA (Chapter

Summons, 52 Fordham L. Rev. 574 (1984); Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729 (2014); Travis Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World,* 148 Tax Notes 207 (July 13, 2015); Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017); J.T. Manhire, *What Does Voluntary Compliance Mean?: A Government Perspective*, 164 U. Penn. L. Rev. 11 (2015); Yvonne Woldeab, *"Americans: We Love You, But We Can't Afford You": How the Costly U.S.-Canada FATCA Agreement Permits Discrimination of Americans in Violation of International Law*, 30 Am. U. Int'l L. Rev. 611 (2015); Samantha McKay, *The Foreign Account Tax Compliance Act: A Constitutional Analysis*,

[23] Megan L. Brackney, *Meet John Doe Summons,* 32 No. 1 Prac. Tax L. 29 (Fall 2017); *See also*, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574 (1984).
[24] Stephan Michael Brown, *One Size Fits Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243 (2014).
[25] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015); *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, (Palgrave MacMillan 2016); Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 101 (October 2013).

9).[26] The book details both of these programs fairly extensively and both programs are highly technical.[27] But again, this book only focuses on two of the measures and was written to explain these measures, not to examine the measures as pieces in the anti-tax evasion framework that allows the IRS to procures U.S. taxpayer information on foreign accounts.

1.2.1. RESEARCH QUESTIONS LINKED

Accordingly, the purpose of this thesis is to explore three questions. First, what measures are being taken by the government to procure taxpayer information on foreign accounts despite bank secrecy laws that prohibit the IRS from properly administering the tax laws? Second, how are these measures implemented in order to address the inability to procure information on U.S. taxpayers' foreign financial accounts abroad? Third, do the measures, when implemented, enable the IRS to obtain formerly inaccessible taxpayer information so that the IRS has all the facts to administer the law fairly and correctly? If the answer to the third question is found to be in the negative, then a fourth question presents itself. If the measures do not permit the IRS to procure the information they need on U.S. taxpayers' foreign financial accounts, what can be done to improve the measures, so it increases the IRS' chances of obtaining taxpayer information on foreign financial accounts?

The four research questions are linked in that the information that results from answering the prior question provides the groundwork to build a firm base for the next question. The first question provides an understanding of the anti-tax evasion measures the U.S. has enacted or developed in order to address the issue that is at the heart of the thesis: the inability to procure taxpayer information on foreign financial accounts so that the IRS has all the facts so that it can administer the tax laws correctly and fairly. Understanding which measures the U.S. has enacted to address this issue

[26] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave Macmillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave Macmillan 2019).
[27] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave Macmillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave Macmillan 2019).

is important because there are numerous and various anti-tax evasion measures – such as the SAARs and GAARs mentioned previously – found in U.S. law which may address tax evasion but that do not give the IRS the ability to obtain information when the taxpayer is not compliant and the information cannot be gotten through a foreign third-party.

This information then leads to the second question which focuses on the specific rules, regulations and programs and how they are implemented so as to effectuate the purpose of obtaining U.S. taxpayer information on foreign accounts. This includes any penalty structure included in the law to encourage/enforce compliance. After coming to an understanding of how the measures are implemented, the third question asks if the measures and the implementation of said measures enable the IRS to obtain formerly inaccessible U.S. taxpayer information on foreign accounts so that the IRS has all the facts to apply the law fairly and accurately. This question asks, "Does it work?" and within that question "What works and what does not work?" If it does not work, then what is insufficient about it?

The questions are applied to each chapter that covers one of the measures (Chapters 4-9). Each chapter names the measure (question 1) and then describes the implementation (which includes penalty structures where appropriate) for how the measure is implemented (question 2). Each chapter includes an evaluation (question 3) – after the knowledge gained through questions 1 and 2 – on whether the anti-tax evasion measure helps the IRS acquire all the facts by obtaining relevant taxpayer information on foreign accounts so that the tax laws can be administered fairly and correctly when previously the IRS had a hard time obtaining the facts (information).

If the measures, when implemented, do not permit the IRS to obtain the information on U.S. taxpayers' foreign financial accounts, then a fourth question presents itself that must be answered at the end of each chapter. If the measure(s) does not permit the IRS to obtain the information needed, what can be done to improve the measure(s) so that it increases the IRS' chances of obtaining the information needed on U.S. taxpayers' foreign accounts ?

1.3. METHOD

To answer the research questions presented, both the legal dogmatics and socio-legal methods are employed. In the main part of the dissertation (Chapters 4-9) legal dogmatics is the main methodology applied to answer the first two questions while socio-legal methodology is utilized to answer the third question and fourth questions. The following subsections describe the two different methodologies that are utilized in this dissertation.

The citation form used throughout the thesis is the Bluebook citation.[28]

1.3.1. LEGAL DOGMATIC METHOD

The first objective of the dissertation is to identify which measures the U.S. employs to procure taxpayer information in situations where the information might not be readily available (or given) and to then describe and analyze how these specific anti-tax evasion measures are implemented in order to address this inaccessibility issue. In order fulfill this objective, legal dogmatics is the primary methodology that has been engaged.

Legal dogmatics from an American perspective (more commonly known in the U.S. as Legal Doctrine[29]), and in the broadest sense, is the coherent, systematic analysis of the law through the interpretation of the statutes and case law.[30] The purpose of it is to aid in the finding and analyzing of the law through the objective examination of

[28] The Bluebook, *found at,* https://www.legalbluebook.com/
[29] A Treatise of Legal Philosophy and General Jurisprudence, Vol. 4: Scienta Juris, *Legal Doctrine as Knowledge of Law and as a Source of Law*, 2 (E. Pattaro, Editor-in-Chief, 2005)
[30] Qunfang Jiang and Yifan Yuan, *Legal Research in International and EU Taxation,* 54 European Taxation 470, 471 (October 2014)

the legal texts, legislative history, case law, any applicable governing principles, persuasive works and academic literature.[31]

Legal dogmatics is defined as "*research that aims to give a systematic exposition of the principles, rules and concepts governing a particular legal field or institution and analyses the relationship between these principles, rules and concepts with a view to solving unclarities and gaps in the existing law*."[32] Jan Smits argues that the doctrinal approach has three important elements that can be seen in practice.[33] The first is that the scholar that uses the legal dogmatic approach is working inside the structure of the legal system which allows the scholar to reflect on the law and suggest alternative measures.[34] This inward looking perspective empowers the researcher to inquire into the law, taking all the facts into account and formalizing a conclusion. It is when the legal dogmatic method turns to an external viewpoint that the legal approach is no longer an entirely sufficient approach to address the issue at hand.[35] This dissertation moves beyond just a legal-dogmatic perspective when it addresses the third question and fourth questions presented so the subsequent section will discuss the socio-legal method. This internal element is reflected in the thesis' selection of relevant legal sources and the explanation of the law that will help in answering the first two questions. It also allows for the suggestion for possible alternatives when answering the third question and fourth questions.

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[31] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 769 (March 2016); *See also*, Jan M. Smits, *What is Legal Doctrine? On the Aims and Methods of Legal-Dogmatic Research*, Maastricht European Private Law Institute, Working Paper No. 2015/06 (September 2015); Roger Cotterrell, *Why Must Legal Ideas Be Interpreted Sociologically?*, 25 J. L. & Soc'y 171 (1998); *Theory and Method in Socio-Legal Research*, 7 (Reza Banakar & Max Travers eds., Hart Publishing, 2005).
[32] Jan M. Smits, *What is Legal Doctrine?*, in Rethinking Legal Scholarship: A Transatlantic Dialogue 207-228 (Rob van Gestel, Hans-W. Micklitz, & Edward L. Rubin eds., 2017).
[33] Jan M. Smits, *What is Legal Doctrine?*, in Rethinking Legal Scholarship: A Transatlantic Dialogue 207-228 (Rob van Gestel, Hans-W. Micklitz, & Edward L. Rubin eds., 2017).
[34] Jan M. Smits, *What is Legal Doctrine?*, in Rethinking Legal Scholarship: A Transatlantic Dialogue 207-228 (Rob van Gestel, Hans-W. Micklitz, & Edward L. Rubin eds., 2017).
[35] Jan M. Smits, *What is Legal Doctrine?*, in Rethinking Legal Scholarship: A Transatlantic Dialogue 207-228 (Rob van Gestel, Hans-W. Micklitz, & Edward L. Rubin eds., 2017).

The second element is that the "*law is seen as a system*" through "*rigorous analysis, creative synthesis, the making of connections between seemingly disparate doctrinal strands, and the challenge of extracting general principles from an inchoate mass of primary materials*" in order to resolve inconsistencies among the various materials and work it into one whole framework.[36] The thesis demonstrates that these pieces are fitted together to present the Internal Revenue Services' anti-tax evasion framework that procures taxpayer information while dealing with obstructions such as secrecy that prohibit it from obtaining said information.

The third and final element is that legal dogmatics puts the present law in order.[37] However, this third element is more reflective of socio-legal methodology (discussed in next section) than true legal dogmatics. Smit argues that the legal-dogmatic approach is "*that it is able to accommodate new developments such as recent case law and legislation against the background of societal change*."[38] This thesis reflects on not only present legislation and case law but also past case law because the American version of legal dogmatics contains the principle of *stare decisis* (discussed in chapter 2) which obligates courts to follow prior case law. So, while this thesis does meet the third element it is in a slightly different way in that it, at times, reflects on past legislation or case law to understand in its entirety the U.S.' approach to obtaining U.S. taxpayer information on foreign accounts.

Since this thesis researches and analyzes U.S. law based on the legal dogmatic method, one must understand both the nature of and how the U.S. federal system works. The United States has a unique, albeit, complicated system[39] - a federalist

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[36] Jan M. Smits, *What is Legal Doctrine?*, in Rethinking Legal Scholarship: A Transatlantic Dialogue 207-228 (Rob van Gestel, Hans-W. Micklitz, & Edward L. Rubin eds., 2017) (quoting the Council of Australian Law Deans)).
[37] Jan M. Smits, *What is Legal Doctrine? On the Aims and Methods of Legal-Dogmatic Research*, Maastricht European Private Law Institute, Working Paper No. 2015/06 (September 2015).
[38] Jan M. Smits, *What is Legal Doctrine? On the Aims and Methods of Legal-Dogmatic Research*, Maastricht European Private Law Institute, Working Paper No. 2015/06 (September 2015).
[39] Konrad Zweigert, *An Introduction to Comparative Law*, pg. 239 (Clarendon Press, 3rd edition, 1998).

government system that is a mix of common law and statutory code.[40] The U.S. federalist system has two parallel governmental systems that function alongside one another: the central federal (national) government and the fifty different state governments. The American system has, after more than two hundred years, evolved into its own distinctive common-law system.[41] The central federal government is inclusive of three equal but separate branches – the legislative, the executive and the judicial – each with different powers that act as a checks and balances system. The legislative branch enacts law while the executive branch enforces the law and the judicial branch interprets it.[42] Within these parallel systems and even within each branch in each system, are multiple sources of law that are relevant to this dissertation in order to answer the questions presented. By working within the structure of the U.S. federal system, the thesis uses the appropriate sources to lay out the current law and regulations that target the inaccessibility problem that the government has in procuring taxpayer information on foreign accounts. The laws and regulations are analyzed throughout the thesis to examine whether they solve the inability to procure the information needed predicament. The subsequent chapter discusses the U.S. federal system and its legal sources in more detail.

Based on the above and using the doctrinal method, the research was focused on the resources that are found within the taxation system in U.S. law. Federal law has been chosen because this thesis focuses on the U.S.' national response – not the individual state response – and, thus, the resources that have been examined are the federal tax resources. Within the federal tax system, those resources are the U.S. tax code and the accompanying tax regulations, legislative history, tax treaties, Internal Revenue Service publications such as notes and press releases and court cases. The legislative history to the tax codes allows for the researcher to understand the purpose and background of the laws which deepens the analysis. The tax regulations also help to

[40] Konrad Zweigert, *An Introduction to Comparative Law*, pg. 239 (Clarendon Press, 3rd edition, 1998).
[41] Konrad Zweigert, *An Introduction to Comparative Law*, pg. 239 (Clarendon Press, 3rd edition, 1998).
[42] Portland State University Library, *United States Government Information: Legislative Branch*, http://guides.library.pdx.edu/c.php?g=271192&p=1811512

explain the legislation that has been enacted. Case law from the federal courts is used, where applicable, to explain the legislation or terms used with the legislation – for example, defining tax evasion.

The dissertation uses these resources to explain what the U.S. has done within the taxation system to deal with the central issue of the dissertation – inability to procure taxpayer information on foreign financial accounts to administer the laws fairly and correctly. The legislation in the thesis has been enacted to address tax evasion in a broader arc and the inability to procure taxpayer information more narrowly. These laws are on the books to shape, hopefully, taxpayer behavior regarding compliance with the tax laws which includes reporting on their foreign accounts.

For example, FATCA and the QI (Qualified Intermediary Program) are utilized to affect the behavior of financial institutions – but also with the objective of shaping the behavior of the taxpayer by encouraging compliance with the law.

The starting point of this thesis is with the doctrinal method and what the law says to help in answering the first two questions. However, that leads to how to answer the third, and fourth questions. To do that, the dissertation turns to the socio-legal method.

1.3.2. SOCIO-LEGAL METHOD

The second objective of this dissertation is to evaluate whether the chosen anti-tax evasion measures allow the IRS to procure taxpayer information so that they can ascertain all the facts in a taxpayer's case in order to administer the tax laws fairly and correctly. The first two thesis questions presented ask "*What is the law*?"[43] and how is it implemented? To get to those answers is a strictly legal dogmatic process.

[43] Kim Economides, *Socio-Legal Studies in Aoteatoa/New Zealand,* 41 J. L. & Soc'y 257 (2014); *See also*, *See also*, Simon Brooman, *Creatures, the Academic Lawyer and a Socio-Legal Approach: Introducing Animal Law into the Legal Education Curriculum*, 38 Liverpool L. Rev. 243, 248 (2014) (quoting Kim Economides, *Socio-Legal Studies in Aoteatoa/New Zealand,* 41 J. L. & Soc'y 257 (2014)).

However, the last two questions asks whether or not the law works[44] and how to improve it if it does not work which results in the analysis taking in broader societal problems, perspectives and concerns.[45] Similarly, The Council for Australian Law Deans states "*At the same time, once legal research broadens into the study of the institutions or processes of the law, the empirical observation of human behavior, or the use of historical methods to illuminate an understanding of the past, it has reached the familiar territory of the humanities and social sciences*."[46]

Socio-legal methodology plays a functionalist role in that it emphasizes the effect of the law in action which is intended to regulate behavior – for this thesis regulating the behavior of the taxpayer and/or financial institutions into complying with tax laws – and "*the efficiency of the remedy to attain the ends for which the precept was devised*."[47] While legal dogmatics delves into not just the statute or case in the present but also the legislative history and prior precedents, socio-legal methodology does not investigate or analyze "*what a legislator thought a century ago*" only what that same legislator would think in present circumstances.[48] It also investigates the impact that legislation has or it chooses to propose new legislation.[49] A decision or statute is only as good as it informs and educates its citizens (in this dissertation, U.S. taxpayers) as to the appropriate social behavior – tax compliance by giving the

[44] Kim Economides, *Socio-Legal Studies in Aoteatoa/New Zealand,* 41 J. L. & Soc'y 257 (2014); *See also, See also*, Simon Brooman, *Creatures, the Academic Lawyer and a Socio-Legal Approach: Introducing Animal Law into the Legal Education Curriculum*, 38 Liverpool L. Rev. 243, 248 (2014) (quoting Kim Economides, *Socio-Legal Studies in Aoteatoa/New Zealand*, 41 J. L. & Soc'y 257 (2014)).
[45] H. Arthurs & A. Bunting, *Socio-Legal Scholarship in Canada: A Review of the Field,* 4 J. Law & Soc. 487 (2014).
[46] Council of Australian Law Deans, *Statement on the Nature of Legal Research, found at* https://cald.asn.au/wp-content/uploads/2017/11/cald-statement-on-the-nature-of-legal-research-20051.pdf
[47] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 779 (2016).
[48] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 781 (2016).
[49] Kim Economides, *Socio-Legal Studies in Aoteatoa/New Zealand,* 41 J. L. & Soc'y 274 (2014).

IRS the information needed to correctly and fairly apply the tax laws to the given fact pattern.[50]

The issue of tax evasion and, more specifically, the central issue of this thesis are considered both a legal issue because it is a violation of tax law but it is also a social issue because the inability to procure taxpayer information does not allow for a fair tax system. Thomas S. Adams, the father of the modern U.S tax system, was concerned with U.S. taxpayers who have foreign accounts being doubly taxed while resident U.S. taxpayers were only taxed once because that did not lead to an equitable system.[51] The same can be said of the reverse situation: taxpayers who have foreign accounts can conceal some of their assets without reporting while those with domestic accounts cannot conceal them and are taxed does not equal a fair and equitable system either. Having measures to try to obtain the taxpayer information despite obstacles such as secrecy influences the behavior of the taxpayer and financial institutions as well as being a deterrent for future behavior by either the same taxpayers and financial institutions or others that have not yet chosen to violate the tax laws yet. According to Roger Cotterrell, legal ideas are a means of structuring the social world and translated to be relevant to this thesis, the legal ideas (or laws) structure how taxpayers should see tax evasion.[52] This means that the measures discussed and analyzed in this thesis should influence the taxpayers' views on tax evasion toward the negative and sway their behavior towards compliance.

Another aspect to the socio-legal methodology is the moral perspective which focuses on social values.[53] This perspective concentrates on identifying societal values – for example, courage, caring and respect. The issue at the center of the

[50] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 781 (2016).
[51] Thomas S. Adams, *International and Interstate Aspects of Double Taxation*, Proceedings of the Annual Conference on Taxation under the Auspices of the National Tax Association, 22 Nat'l Tax Assoc. 197 (1929).
[52] Roger Cotterrell, *Why Must Legal Ideas Be Interpreted Sociologically*, 25 J.L. & Soc'y 192 (1998).
[53] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 769 (2016).

thesis – inability to obtain taxpayer information – concerns the societal values of honesty, trust and fairness. The U.S. taxation system trusts that U.S. taxpayers will be honest and comply with the tax rules and disclose to the IRS the correct information so that the IRS can fairly administer the tax rules to the case in front of them. However, the U.S. taxation system also uses the threat of being audited, third-party reporting and penalties as coercion into complying in case a U.S taxpayer contemplates violating that trust.

With all this in mind, Chapter 3 reflects upon what the conversation has been previously (tax havens) and what has been done to address the issue (blacklists and definitions) and acknowledging that this is not the real problem but instead is a distraction from the real issue – secrecy – which prevents the IRS from procuring the taxpayer information they need to administer the laws fairly and correctly. Chapters 4-9, while identifying and analyzing the legal sources, asks the question whether the measures, when implemented, address the inability to procure taxpayer information. This question will also reflect upon whether the measures motivates taxpayers and foreign third-parties (via the Qualified Intermediary Program and Foreign Account Tax Compliance Act in Chapter 7 and 9) to disclose the information needed.[54] Do these measures have the desired effect on motivating taxpayers or foreign third-parties to disclose the information needed?

The law (or legal dogmatics) does not explain the societal response to tax evasion and bank secrecy and the use of it. It also does not explain potential changes in behavior due to the law or the strengthening of laws. The Socio-Legal methodology will help answer the third question of this thesis by analyzing whether the measures taken will alter the behavior of the taxpayer and foreign third-parties and whether the IRS will be able to procure the information that they have not be able to obtain before.

[54] Richard Langone, *The Science of Sociological Jurisprudence as a Methodology for Legal Analysis*, 17 Touro L. Rev. 769 (2016).

1.4. CORE CONCEPTS

1.4.1. TAX AVOIDANCE VERSUS TAX EVASION

Considering this thesis' topic revolves around tax evasion, a definition and explanation of what tax evasion is or is not and why tax avoidance is not considered within this thesis is warranted. Confusion with the two terms has long been an issue and many, including politicians themselves, conflate the two terms[55] However, they should not be conflated because as this section shows tax evasion is an illegal act while tax avoidance, which is morally and ethically questionable, is a legal one.

Generally speaking, tax avoidance is the legal arrangement of a taxpayer's affairs with the purpose of reducing his/her tax liability and while avoidance falls within the bounds of the law; it contradicts the true intent of the law.[56] This thesis is focused on tax evasion or the illegal use of the law and not tax avoidance.

A good place to start the discussion of why this thesis has chosen a tax evasion focus and not avoidance is to examine the basic definition of both. Black's Law Dictionary defines tax evasion as "*the willful attempt to defeat or circumvent the tax law in order to illegally reduce one's tax liability"* and notes that tax evasion is also referred to as tax fraud.[57] The Oxford's Dictionary of Law is a bit broader in its definition as it defines tax evasion as *"any illegal action to avoid the lawful assessment of taxes."*[58]

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[55] Montgomery B. Angell, *Tax Evasion and Tax Avoidance*, 38 Columbia L. Rev. 80 (Jan. 1938).
[56] William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518 (1937; *See also,* Lucius A. Buck, *Income Tax Evasion and Avoidance: The Deflection of Income*, 23 Virginia L. Rev. 107 (Dec. 1936); Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion*, 40 IMF Staff Papers 807, 808 (Dec. 1993) (Footnote #2); Michael W. Spicer, *Civilization at a Discount: The Problem of Tax Evasion*, 39 Nat'l Tax J. 13 (March 1986); Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion,* Congressional Research Service (January 15, 2015); Steven A. Bank, *When Did Tax Avoidance Become Respectable?,*71 Tax L. Rev. 123-177 (2017); Cihat Öner, *Is Tax Avoidance the Theory of Everything in Tax Law? A Terminological Analysis of EU Legislation and Case Law*, EC Tax Rev. 96 (2018); Doreen McBarnet, *Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality,* 3 J. Human Justice, 56, 58 (1992); Paulus Merks, *Tax Evasion, Tax Avoidance and Tax Planning*, 34 Intertax 272, 273 (2006).
[57] Black's Law Dictionary, 1474 (7th ed. 1999).
[58] Oxford Dictionary of Law (8th ed. 2015).

The OECD's glossary of terms also defines avoidance and evasion. The glossary notes that it is difficult to define avoidance but that it "*is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability……the arrangement could be strictly legal*" however, as the definition points out is usually in contradiction with the spirit of the law.[59] Tax evasion, on the other hand, is defined as "*illegal arrangements where liability to tax is hidden or ignored*."[60] The definitions seem to denote two categories of action – it is either evasion or avoidance – by the simple use of the term illegal(ly). Other dictionaries define the concept similarly.[61]

The next step is to look to the academics and how they define the distinction between tax evasion and tax avoidance. Scholarly definitions range from the two concepts meeting in a gray area while others argue that there are clear boundaries between the two.[62] Overall, though, there is a consensus that tax avoidance is legal while tax evasion is not.

In a paper published by the International Monetary Fund (IMF), an organization that works towards global monetary and financial cooperation[63], the authors note that scholars typically differentiate between tax avoidance and tax evasion.[64] Tax evasion, according to these authors, is a violation of the law and in contrast, tax

[59] OECD, *Glossary of Tax Terms, found at* https://www.oecd.org/ctp/glossaryoftaxterms.htm
[60] OECD, *Glossary of Tax Terms, found at* https://www.oecd.org/ctp/glossaryoftaxterms.htm
[61] *See*, Barron's Legal Guides, 37, 483 (3rd ed. 1991); Oxford Dictionary of Law (8th ed. 2015); Merriam-Webster.com Legal Dictionary, Merriam-Webster, https://www.merriam-webster.com/legal/tax%20evasion
[62] William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518 (1937; *See also,* Lucius A. Buck, *Income Tax Evasion and Avoidance: The Deflection of Income*, 23 Virginia L. Rev. 107 (Dec. 1936); Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion*, 40 IMF Staff Papers 807, 808 (Dec. 1993) (Footnote #2); Michael W. Spicer, *Civilization at a Discount: The Problem of Tax Evasion*, 39 Nat'l Tax J. 13 (March 1986); Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, Congressional Research Service (January 15, 2015); Steven A. Bank, *When Did Tax Avoidance Become Respectable?*,71 Tax L. Rev. 123-177 (2017); Cihat Öner, *Is Tax Avoidance the Theory of Everything in Tax Law? A Terminological Analysis of EU Legislation and Case Law*, EC Tax Rev. 96 (2018); Doreen McBarnet, *Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality*, 3 J. Human Justice, 56, 58 (1992); Paulus Merks, *Tax Evasion, Tax Avoidance and Tax Planning*, 34 Intertax 272, 273 (2006).
[63] International Monetary Fund, https://www.imf.org/en/About
[64] Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion*, 40 IMF Staff Papers 807, 808 (Dec. 1993) (Footnote #2).

avoidance is taxpayers using ambiguities within the law (key) in order to reduce taxes.[65] It is important to note that tax evasion does not constitute a crime in all countries, unlike the United States, where it is a crime which can present conflict between the U.S. and a foreign country.[66] Consequently, the definition of what qualifies as tax evasion will also vary country to country. For example, Switzerland does not consider tax evasion a crime, instead it is considered a civil matter[67] and actions that qualify as tax evasion under Swiss law are considered as both fraudulent and tax evasion under U.S. law.[68] This issue will be considered further in the chapter on Treaties (Chapter 8).

Douglas J. Workman distinguished tax avoidance and tax evasion stating that tax avoidance happens when a taxpayer arranges his or her affairs within what the law allows.[69] Tax evasion, according to this same scholar, "*involves acts intended to misrepresent or to conceal facts in an effort to escape lawful tax liability*."[70] Michael W. Spicer notes that tax evasion is the reduction of the taxpayer's tax liability using illegal or fraudulent means and that tax avoidance is reducing a taxpayer's tax liability within the provisions in the tax law.[71] He asserts that there is a third

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[65] Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion,* 40 IMF Staff Papers 807, 808 (Dec. 1993) (Footnote #2).
[66] Ellen C. Auwarter, *Compelled Waiver of Bank Secrecy in the Cayman Islands: Solution to International Tax Evasion or Threat to Sovereignty of Nations*, 9 Fordham Int'l L. J. 680, 681 (1985/1986); *See also, Tax Haven Banks and U.S. Tax Compliance: Obtaining the Names of U.S. Clients With Swiss Accounts: Hearing before the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs*, 111th Cong. 5 (2009) (Opening Statement of Senator Carl Levin); https://www.swissinfo.ch/eng/-private-sphere-_parliament--don-t-touch-banking-secrecy-for-swiss-clients/43748818; Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 702 (Summer 1982).
[67] Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 702 (Summer 1982); *See also*, Paulus Merks, *Tax Evasion, Tax Avoidance and Tax Planning*, 34 Intertax 272, 273 (2006).
[68] Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 703 (Summer 1982).
[69] Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 677 (Summer 1982).
[70] Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 677 (Summer 1982).
[71] Michael W. Spicer, *Civilization at a Discount: The Problem of Tax Evasion,* 39 Nat'l Tax J. 13 (March 1986).

possibility that is termed "*avoision*" – which originated in 1979[72] – and that this is where the lines between tax avoidance and tax evasion are blurred. The term avoision refers to the "questionable legality" of the tax avoidance transaction undertaken.[73] However, this "*avoision*" seems to be the gray area that exists *before* the court finds whether or not it is within the bounds of the law.

Interestingly, one scholar described tax avoidance as a "halfway house" of tax law because tax avoidance is not quite full compliance with the law but it is also not a direct abuse of the law.[74] However, the same article notes that tax avoidance does not qualify as either a criminal or a regulatory offense[75]; it is a legal use of the law. Steven A. Bank, through the title of his article, seems astonished that tax avoidance has become respectable and he points to the United States in the 1930s and the attitude towards tax avoidance.[76] "*During the 1930s, even the use of perfectly legal provisions for reducing income taxes was attacked as morally suspect."*[77] He goes on to argue that many believe that tax avoidance became respectable when Judge Learned Hand stated in an important case distinguishing tax evasion and avoidance that taxpayers may arrange their affairs so that their tax liability is as low as possible.[78] However, avoidance, in this author's opinion, has never been respectable among politicians or the authorities which is represented through their conflation of the tax evasion and avoidance terms as well as the closing of loopholes[79] that allow

[72] Doreen McBarnet, *Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality*, 3 J. Human Justice, 56, 58 (1992) (citing Arthur Seldon, Tax Avoision: The Economic, Legal and Moral Inter-Relationships between Avoidance and Evasion, Institute of Economic Affairs (1979)).
[73] Michael W. Spicer, *Civilization at a Discount: The Problem of Tax Evasion,* 39 Nat'l Tax J. 13 (March 1986).
[74]Doreen McBarnet, *Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality*, 3 J. Human Justice, 56, 58 (1992).
[75] Doreen McBarnet, *Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality*, 3 J. Human Justice, 56, 58 (1992).
[76] Steven A. Bank, *When Did Tax Avoidance Become Respectable?*,71 Tax L. Rev. 123-177 (2017).
[77] Steven A. Bank, *When Did Tax Avoidance Become Respectable?*,71 Tax L. Rev. 123-177 (2017).
[78] *Gregory v. Helvering*, 69 F.2d 809 (1934); *See also*, Steven A. Bank, *When Did Tax Avoidance Become Respectable?*,71 Tax L. Rev. 123-177 (2017).
[79] William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518 (1937).

people to manage their taxes legally. U.S. taxpayers, on the other hand, have always tried to lower – or avoid – their tax liability even in America's early years as a nation. Samuel Adams, the father of the American Revolution, argued that it was a natural, God-given right for a person to enjoy their property (including money) and have the sole disposal of it and he knew how much Americans hate paying taxes.[80]

There is a distinction between tax evasion and tax avoidance and case law and the statutes support that. When there is a question about whether it is one or the other (gray area), it becomes a question for the courts. One cannot designate tax avoidance as tax evasion until Congress decides to close the loopholes that they deem questionable and once the law is enacted, then that action, if it violates the law, qualifies as tax evasion.

The term loopholes can be viewed as a pejorative term because loopholes (avoidance) are legal (law) until Congress enacts that law that closes those loopholes and makes it illegal. So, to use the term loophole in the negative and claim it is tax evasion before the law makes it evasion seems disingenuous. For example, anyone who takes a deduction is *avoiding* tax because it is allowed under the United States Tax Code. It becomes a problem and ventures into *evasion* when one begins to shade the interpretation of the law and use the law inappropriately to take the deduction. Although this example is an extreme one, it is illustrative.

Despite knowing generally how tax evasion and tax avoidance are defined among the academic world, the question that is specific to this thesis becomes how does the U.S. define what tax evasion is versus tax avoidance? In 1954, Congress enacted a statute, the codification of case law, which made it a felony to willfully attempt to evade or defeat any tax imposed under the Revenue Code no matter how the attempt to evade was done.[81] 26 USC §7201 is the U.S. statute that makes a willful evasion of tax a felony.[82] The statute itself states "*Any person who willfully attempts in any*

[80] Ira Stoll, *Samuel Adams: A Life*, 66 (Free Press, 2008).
[81] 26 U.S.C. §7201
[82] 26 U.S.C. §7201

manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony…"[83] The statute provides three elements that are needed to prove that a taxpayer committed the felony offense of tax evasion: 1) willfulness (intent), 2) existing tax deficiency and 3) an affirmative act constituting an evasion.[84] The question for this section is what qualifies as evasion as opposed to avoidance since the statute does not mention avoidance as a crime?

The statute is the starting point of course; however, it does not provide a definition of tax evasion other than to state that to do so is a felony. To provide clarification of what tax evasion is, U.S. case law and their holdings should be examined. How do the courts define tax evasion and differentiate between tax evasion and tax avoidance?

The question of what is considered tax evasion and what is considered tax avoidance was being considered as early as 1873 by the Supreme Court and by a series of early 20th century cases. *United States v. Isham*[85] held that if avoiding a tax is done by *legal* means, then there is no "legal censure".[86] In other words, as long as the transaction/device used to avoid taxes is legal, then the action falls within the bounds of the law and does not qualify as tax evasion and is not a crime.

In another U.S. Supreme Court case, *Bullen v. Wisconsin*, the Court outlines a pretty clear picture as to what constitutes avoidance versus evasion.[87] The Court illustrated the difference by drawing an invisible line and noting that a case falls either on one side of the line or the other.[88] When a party works within the law and what it permits he falls on the avoidance side of the line, however, when "*an act is condemned as*

[83] 26 U.S.C. §7201.
[84] 26 U.S.C. §7201; *See also, Sansone v. U.S.*, 380 U.S. 343 (1965); *Spies v. United States*, 317 U.S. 492 (1943).
[85] William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518 (1937).
[86] *United States v. Isham*, 84 U.S. 496 (1873)
[87] *Bullen v. State of Wisconsin*, 240 U.S. 625 (1916).
[88] *Bullen v. State of Wisconsin*, 240 U.S. 625 (1916); *discussed in* William Cogger, *supra*, note 2.

evasion what is meant is that it is on the wrong side of the line indicated by policy if not by the mere letter of the law."[89]

Judge Learned Hand in *Gregory v. Helvering* clearly stated the law when he said "*Anyone may so arrange his affairs that his taxes shall be as low as possible*…."[90] The Supreme Court agreed with Judge Hand when the case reached them and reiterated that a taxpayer has the legal right to reduce or avoid his or her taxes as long as it falls within the bounds of the law.[91]

According to *Spies v. United States*, tax evasion as a crime only occurs when one willfully and blatantly attempts to disregard their tax liability.[92] The court then creates a list (non-limiting) that provides examples of actions that would constitute tax evasion: creating and keeping a double set of books, entries that are either false or altered, creating false invoices or documents, destroying said books and records, etc.[93] This list is an important example of tax evasion because tax evasion is not just one type of action but, instead, can take many forms and those who choose to evade (or help the evaders) are continually evolving.[94]

A 1st Circuit Court of Appeals case, *Wiggins v. Commissioner*, states the test on how to determine whether a transaction qualifies as evasion or avoidance is simply determining whether or not the transaction was real or sham.[95] The motive that one has to reduce taxes is irrelevant. "*The motive or desire to reduce or escape taxes is almost universal, and, if not given play through sham or fraudulent transactions, entirely legitimate."*

[89] *Bullen v. State of Wisconsin*, 240 U.S. 625 (1916).
[90] *Gregory v. Helvering*, 69 F.2d 809 (1934).
[91] *Gregory v. Helvering*, 69 F.2d 809 (1934), *aff'd by* 293 U.S. 465 (1935).
[92] *Spies v. U.S.*, 317 U.S. 492 (1943).
[93] *Spies v. U.S.*, 317 U.S. 492 (1943).
[94] Vito Tanzi and Parthasarathi Shome, *A Primer on Tax Evasion,* 40 IMF Staff Papers 807, 809 (Dec. 1993)
[95] *Wiggins v. Comm'r,* 46 F.2d 743 (1st Cir. 1931); William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518 (1937).

Following the logic of *Bullen* and the other cases, when the transaction has been found to fall within the bounds of the statute, then it is tax avoidance which is legal. The issue is then black and white: evasion or avoidance. While the politicians argue that tax avoidance is also bad for the country because of the loss of revenue, the Supreme Court has declared that it is legal so the way Congress has chosen to address tax avoidance is to close loopholes that exist within the law that allow taxpayers to legally avoid paying tax. Many of the scholars as discussed above have remarked that the difference between tax avoidance and tax evasion is that one is legal, and one is illegal which is on par with the line-in-the-sand test stated in *Bullen v. Wisconsin*. Either its tax avoidance because it falls within the statute and is a legal action/transaction or it falls outside of the statute's borders and is an illegal action, or tax evasion. The only gray area that presents itself is considering whether the act falls within the statute – in order to be considered legal – or not. Once that decision has been made by the court, it is either illegal or it is not.

Using the phrase tax avoidance in reference to the multiple tax schemes – for example, financial institutions in tax havens that issue their account holders credit cards so that they have access to their funds which most like have not been reported to the IRS[96] – offered through jurisdictions that offer secrecy is disingenuous and misleading. The schemes and programs that allow the taxpayer to conceal their accounts (including the use of credit cards linked with that account) without reporting them is not tax avoidance, it is tax evasion which is illegal. The only way it is not tax evasion is if the taxpayer reports the foreign accounts to the IRS.

Another reason that this thesis is focused on evasion and not avoidance is because the legislative history and congressional reports indicate that tax evasion was the true goal of the legislation like the Foreign Account Tax Compliance Act (Chapter 9) and the Bank Secrecy Act (Chapter 4). Despite the politicians conflating the terms

[96] See Chapter 6 on John Doe Summonses, specifically subsection 6.2.1.3, for reference to the OCCP (Offshore Credit Card Program) which addressed this type of scheme.

in these legal sources as they have done for one hundred years or more, their true goal is targeting illegal behavior – or tax evasion.

This thesis is concerned about tax evasion only for a couple of reasons. First, according to the U.S. law there is a distinct line between tax avoidance and tax evasion. Since tax evasion is the illegal act, this thesis is concerned with that act only – not the acts considered legal (avoidance) by law. Second, despite the politicians and authorities bemoaning the immorality and deceitfulness of both tax avoidance and tax evasion, the legislative history of the legislation examined in this thesis reflects the need to address tax evasion and actually meaning tax evasion despite using the two terms in conflation with one another.[97]

1.4.2. ACCESS TO TAXPAYER INFORMATION

The issue presented by this thesis is that the IRS cannot accurately examine the taxpayer's case in order to adequately and fairly administer the tax laws without being able to fully procure the taxpayer's information on foreign accounts so that the IRS has all the facts in front of them. One of the main concepts when analyzing the issue and the measures that the U.S. government has taken in response to the issue is the problem of *accessing taxpayer information*. Much of the literature presented also uses

[97] U.S. Senate Permanent Subcommittee on Investigations, *Offshore Tax Evasions: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts*, Homeland Sec. & Governmental Affairs Permanent Subcommittee on Investigations (2008); *See also*, U.S. Senate Permanent Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance: Obtaining the Names of U.S. Clients with Swiss Accounts*, Senate Hearing No. 111-30 (March 4, 2009); U.S. House Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance*, House Hearing, No. 111-35 (November 5, 2009); United States Senate Committee on Finance, *Offshore Tax Evasion: Stashing Cash Overseas*, Senate Hearing No. 110-677 (May 3, 2007); United States Permanent Subcommittee on Investigations, *What is the U.S. Position on Offshore Tax Havens*, Senate Hearing No. 107-152 (July 18, 2001); United States Senate Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, Senate Hearing No. 91-1139 (August 24, 1970); 91 Cong. Rec. 32627 (September 18, 1970); 91 Cong. Rec. 16950 (May 25, 1970);

that phrase to describe the problem that is confronting the Internal Revenue Service (IRS).[98] But what exactly does the expression "*accessing taxpayer information*" mean? Since this thesis refers to and examines U.S. law and regulations, this thesis will look at those resources to discern what accessing taxpayer information means within U.S. law.

Domestically, the IRS has access to taxpayer returns (if taxpayers file them[99]) as well as third-party information such as financial institutions reporting interest or dividends but when entering international tax waters the access that the IRS has to this type of information virtually vanishes. There is no law or regulation requiring another country or the country's financial institutions to comply and provide information to the IRS regarding U.S. taxpayers' accounts in that country as there is in the U.S. with U.S. financial institutions and employers.

26 U.S.C. §6001 requires U.S. taxpayers to not only file returns but to keep records that relate to the tax returns.[100] U.S. taxpayers, that are liable for tax, are required to file tax returns and provide the IRS with information on that return so that the IRS can equitably and correctly administer the tax laws[101].

The question becomes what qualifies as taxpayer information? 26 U.S.C. §6103, which is the statute covering confidentiality and disclosure of returns and return

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[98] United States Senate, Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, S. Rep. 91-1139 (August 24, 1970); *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, (Palgrave MacMillan 2016); U.S. Senate Permanent Subcommittee on Investigations, *Offshore Tax Evasions: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts*, Homeland Sec. & Governmental Affairs Permanent Subcommittee on Investigations (2008), *available at* http://hsgac.senate.gov/subcommittees/investigations/hearings/offshore-tax-evasion-the-effort-to-collect-unpaid-taxes-on-billions-in-hidden-offshore-accounts ; *see also*, Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism*, 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015)*;* U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008)

[99] If the taxpayer does not file, he is potentially subject to 26 U.S.C. §7203 which is a statute that covers failure, both willful and non-willful, to file.

[100] 26 U.S.C. §6001; 26 U.S.C. §6011(a).

[101] 26 U.S.C. §6011(a).

information, answers this question. §6103 defines the term taxpayer return information as return information. To discover what "*return information*" is defined as, one looks in the paragraph just prior to §6103(b)(3).[102] Under this statute, the return information is defined as

> ***A)*** *a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,*
>
> ***(B)*** *any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,*
>
> ***(C)*** *any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and*
>
> ***(D)*** *any agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement, but such term does not*

[102] 26 U.S.C. §6103(b)(3).

> *include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. Nothing in the preceding sentence, or in any other provision of law, shall be construed to require the disclosure of standards used or to be used for the selection of returns for examination, or data used or to be used for determining such standards, if the Secretary determines that such disclosure will seriously impair assessment, collection, or enforcement under the internal revenue laws.*[103]

Taxpayer identity is defined as not just the name of the person but also the mailing address and his taxpayer identification number which in the U.S. is usually the person's social security number.[104] But the IRS needs more than just a taxpayer return and what the taxpayer submits to know all the facts surrounding the taxpayer's situation in order to equitably and fairly administer the tax laws. Under domestic law, third-party institutions such as employers and financial institutions are required to file various forms with the IRS to report income and assets of the taxpayer.[105]

Another place to look to see what the IRS considers part of the taxpayer information is under the subpoena powers that the IRS has (which will be discussed in further detail in Chapter 6, John Doe Summons). The IRS has been given a "*powerful tool*" by Congress in order to exert their authority in making certain that returns are correct or ascertaining the liability of a taxpayer.[106] Under 26 U.S.C. §7602, the IRS has the power to "*examine any books, papers, records, or other data which may be relevant or material to such inquiry*" as well as to summon witnesses (including the taxpayer,

[103] 26 U.S.C. §6103(b)(2).
[104] 26 U.S.C. §6103(b)(6).
[105] 26 U.S.C. §3402; *See also*, IRS, Instructions for Forms W-2 and W-3 https://www.irs.gov/pub/irs-pdf/iw2w3.pdf
[106] 26 U.S.C. §7602.

employee of financial institutions, etc.) and to seek testimony.[107] These statutes together give a bigger picture as to what qualifies as taxpayer information is and in order to administer the laws correctly to the taxpayer's situation, the IRS needs access to this information from the various parties. Another way to phrase "*access to taxpayer information*" is "*information procurement*".[108]

Domestically, the system described above (albeit briefly) works. This thesis, though, is concerned with the scenario where the IRS is evaluating a taxpayer who maintains accounts in a foreign jurisdiction and either the taxpayer is not providing the information they are required to under U.S. law, the IRS cannot get information from third parties because the U.S. cannot compel third parties to produce information on the U.S. taxpayer(s) in question or there is an obstacle such as bank secrecy prohibiting the IRS from doing so. Consequently, this thesis is focused on what measures the U.S. takes to gain that access that they might not have currently and how effective those measures are in gaining that access – or procuring taxpayer information.

1.4.3. CORRECTLY AND FAIRLY

When examining and discussing the answers to the research questions, the words "*correctly*" and "*fairly*" are used in reference to the IRS being able to have all the facts about a taxpayer's filing (tax return and all information relevant to that return) in order to administer the tax law *correctly* and *fairly*.

The word fair, according to Black's Law dictionary, means impartial, just, equitable and free from bias.[109] The word correct is defined as conforming to an approved or conventional standard.[110]

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[107] 26 U.S.C. §7602.
[108] Denmark National Report, *Tax Transparency*, EATLP 2018 Congress; *See also*, Japan's National Report, *Tax Transparency*, EATLP 2018 Congress; United Kingdom National Report, *Tax Transparency*, EATLP 2018 Congress; Belgium National Report, *Tax Transparency*, EATLP 2018 Congress.
[109] Black's Law Dictionary, 7th edition (Editor Bryan A. Garner 1999).
[110] Merriam-Webster Dictionary, *found at* https://www.merriam-webster.com/

The concepts of correctly and fairly simply means – within the context of this thesis – is that the IRS will apply (administer) the right tax laws (correctly) to the taxpayer's situation given that they have all the facts and that how they apply those tax laws is not different from one taxpayer to the next (again given they have all the facts regarding the taxpayer's situation) (fairly).

1.4.4. PENALTIES

This section will discuss penalties and the distinction between civil and criminal penalties in U.S. law briefly as several measures discussed in this thesis have a penalty structure as part of the anti-tax evasion measure.[111]

The Internal Revenue Code (IRC) provides for both civil and criminal penalties.[112] It also gives the authority to the IRS to assess both types of penalties.[113] The purpose behind the use of penalties generally is to encourage compliance and to deter behavior that does not meet the standards required under the Internal Revenue Code – for example, accurate returns, timely filing and paying any tax liability.[114]

There are several distinctions between these civil and criminal penalties. Civil penalties are remedial in nature and are in place to protect the revenue.[115] These types of penalties are also used to defray the cost of the IRS investigation into tax matters. The burden of proof lies with the IRS to prove by clear and convincing evidence[116]

[111] 26 U.S.C. §7201
[112] *Helvering v. Mitchell*, 303 U.S. 391 (1938).
[113] 26 U.S.C. §7201; *See also*, Internal Revenue Manual 20.1
[114] Internal Revenue Manual 20.1.1.2; *See also*, Michael Doran, *Tax Penalties and Tax Compliance*, 46 Harv. J. on Legis. 111 (2009).
[115] *Helvering v. Mitchell*, 303 U.S. 391 (1938); *See also*, William H. Ise, *The Relationship Between Civil and Criminal Tax Fraud and its Effect on The Taxpayer's Constitutional Rights*, 12 B.C.L. Rev. 1176 (1971); J. Morris Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 Minn. L. Rev. 379 (1975).
[116] Clear and convincing evidence means that the evidence must be more than a 50% probability of being true.

that the taxpayer owes civil penalties.[117] In contrast, criminal penalties are punitive in nature and the purpose behind utilizing this type of penalty is deterrence.[118] The IRS is held to a beyond a reasonable doubt[119] standard when proving criminal penalties which is the highest legal standard in the U.S. legal system.[120] Even the statute of limitations is different between civil and criminal penalties. In a civil penalty case, there is no statute of limitations but in a criminal penalty case the statute of limitations is six years.[121]

A taxpayer can be liable for civil penalties, criminal penalties or both. If a taxpayer is assessed both civil and criminal penalties, under U.S. law, this does not constitute double jeopardy.[122] The reasoning behind this is that the burdens of proof that are applied and the nature of the penalties – remedial versus punitive – for civil and criminal penalties are different.[123]

The discussion of penalties leads to a question about whether a taxpayer can appeal the penalties or is that the end for the taxpayer? Subsection 2.5.1 in Chapter 2 discusses the different courts that have jurisdiction over tax matters and whether a case can be appealed to a higher court.

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[117] William H. Ise, *The Relationship Between Civil and Criminal Tax Fraud and its Effect on The Taxpayer's Constitutional Rights,* 12 B.C.L. Rev. 1176 (1971); J. Morris Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 Minn. L. Rev. 379 (1975).
[118] William H. Ise, *The Relationship Between Civil and Criminal Tax Fraud and its Effect on The Taxpayer's Constitutional Rights,* 12 B.C.L. Rev. 1176 (1971); J. Morris Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 Minn. L. Rev. 379 (1975).
[119] The reasonable doubt standard means the proof is close to an absolute certainty that one is in this instance guilty of evading taxes and, thus, owes criminal penalties.
[120] William H. Ise, *The Relationship Between Civil and Criminal Tax Fraud and its Effect on The Taxpayer's Constitutional Rights*, 12 B.C.L. Rev. 1176 (1971); J. Morris Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 Minn. L. Rev. 379 (1975).
[121] Internal Revenue Manual 20.1
[122] *Helvering v. Mitchell*, 303 U.S. 391 (1938).
[123] *Helvering v. Mitchell*, 303 U.S. 391 (1938); *See also*, William H. Ise, *The Relationship Between Civil and Criminal Tax Fraud and its Effect on The Taxpayer's Constitutional Rights*, 12 B.C.L. Rev. 1176 (1971); J. Morris Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 Minn. L. Rev. 379 (1975).

1.5. DELIMITATION

Despite the work of this thesis within the U.S. federal system, the federal system itself provides limitations. This means that how the federal system is set up instructs the researcher on the exact sources to use for a specific legal issue or question. For example, if the problem surrounds an issue in family law, the legal sources will only be found at the state level since the Constitution did not grant the federal government power over family matters. Therefore, in that scenario, only state statutes, case law and regulations will be examined. However, if the question revolves around naturalization and immigration, then that falls within the jurisdiction of the federal government.[124] Consequently, the sources to be used in researching an immigration issue would be all federal legal sources that pertain to the issue. For this thesis, when focusing on the federal response to the issue of the inability to procure taxpayer information on foreign accounts, then only federal sources of law are examined. The opposite would be true if examining the state level responses to the tax evasion/foreign accounts abroad issue and state legal sources are reviewed. The states' responses to this issue are not covered in this thesis because that is an entire independent thesis question of its own.

The pieces of legislation and programs researched and analyzed in Chapters Five through Nine have been chosen because they are the pieces of legislation or programs that address the IRS' inability to obtain U.S. taxpayer information on foreign accounts. If this thesis was a wider thesis discussing tax transparency specifically or even the very broad topic of tax evasion, there would be other legislation and programs to study and analyze – for example, Special Anti-Avoidance Rules (SAARs) and General Anti-Avoidance Rules (GAARs).

The nature of the Foreign Tax Account Compliance Act (FATCA – Chapter 9) and the other legal statutes and regulations such as the Qualified Intermediary Program (Chapter 7) lend themselves to various perspectives that could lead to discussions on

[124] U.S. Const. Sec. 8, art. 4

the potential for human rights violations regarding taxpayers or the perspectives that the foreign financial institutions hold. Similarly, the burden placed on FFIs to comply with FATCA and how they would accomplish that, while also certainly an interesting discussion, is beyond the scope of this paper. Another potential human rights violation from a non-U.S. perspective could stem from the possibility of both civil and criminal penalties being pursued and applied to a taxpayer. The extra-territorial nature of FATCA presents multiple issues regarding whether FATCA violates international conventions. Most of these topics are thesis questions in and of themselves. However, in order, to maintain focus within the dissertation, this dissertation will only address the anti-tax evasion measures from the perspective of and the actions taken by the U.S federal government to procure U.S. taxpayers' information on their foreign accounts.

The FATCA and QI measures are extremely complicated pieces of law that include both statutes and regulations. Ross K. McGill's U.S. Withholding Tax: Practical Implications of QI and FATCA was an in-depth book written on the two measures.[125] This thesis covers the most central parts of FATCA and the QI which focuses on addressing the research questions presented. If this thesis were to include the entirety of FATCA and the QI a separate dissertation, or a book such a Ross K. McGill's book, would be needed. Also, another issue that cannot be covered in this thesis due to the complexity of it is the convergence of FATCA and the QI in certain places such as KYC/AML due diligence or the use of certain tax forms. Therefore, for the sake of clarity and conciseness for the reader, each measure is dealt with on its own with only an occasional reference to the similarities found between the two.

While the OECD and the EU both have measures that address this topic, such as the OECD's Common Reporting Standards (CRS), these are not included in this dissertation since this dissertation is only concerned with U.S. law and the U.S. government's perspective. The EU, the OECD and the FATF are only mentioned

[125] Ross K. McGill, *US Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2013).

briefly in Chapter 3 in the discussion of definitions and the blacklisting of tax haven jurisdictions.

Another issue that presents itself is that of the concern of privacy issues regarding Article 26 in the U.S. Model Income Tax Convention relating to the EU General Data Protection Regulation. However, this discussion is beyond the scope of this thesis so it will not be discussed.

In Chapter 3, an interesting issue that presents itself is the two-prong attack taken against tax havens. The two-prong attack consists of first attacking the tax havens from a political standpoint and deciding what a tax haven is and what jurisdictions to attack. The second prong consists of relying on international remedies. This issue could lend itself its own thesis and is outside the scope of this thesis but needed to be acknowledged within the context of Chapter 3.

In Chapter 7, the John Doe Summons Chapter, could give way to a 4th amendment discussion on search and seizures and how that relates to the John Doe summons but that is also beyond the scope of this thesis and could be a thesis question in and of itself.

The nature of the dilemma of tax evasion and the inability to procure taxpayer information on foreign accounts is such a broad issue that envelopes many different facets this thesis cannot claim to have found all the appropriate materials that address the research questions of this thesis. As subsection 1.41 states this thesis is concerned only with tax evasion and not tax avoidance.

The problem that prohibits the IRS from obtaining information on U.S. taxpayers' foreign accounts is secrecy. The thesis is concerned with foreign jurisdictions' secrecy and the effect it has on the ability to procure information so that the IRS has all of the facts to administer the tax laws correctly and fairly. There is not a focus on U.S. secrecy rules (or the argument that the U.S. is a tax haven) because the thesis is concerned with inbound information from other countries who have secrecy rules that effect the ability to procure the inbound information.

The research questions presented in this dissertation demonstrate that the viewpoint of this thesis is from the U.S. government's perspective. Inaccessibility to taxpayer information can open discussions from multiple perspectives: the taxpayer and involuntary compliance, foreign third-party non-compliance or foreign governments and bank secrecy. Those identify just a few and even those topics present other issues such as human rights violations. However, this thesis' focus is on how the U.S. government – through the IRS – can procure information on taxpayers' foreign accounts that they normally cannot get access to due to bank secrecy or even strict privacy rules. So, the conceptual approach throughout the thesis is the viewpoint of the U.S. government.

The research behind the thesis ended in May of 2019. There are a few areas where research was done to ensure information was up to date. For example, the section in Chapter 8 that deals with the 2009 Protocol to the 1996 U.S. – Swiss Treaty needed to be updated since ratification on the protocol occurred in July of 2019.

1.6. OUTLINE

The remainder of the thesis is divided into eight chapters. Since the thesis is focused on the United States and no other jurisdictions, the thesis uses the various legal sources found within the U.S. federal system, for instance, statutory law and case law. Therefore, Chapter 2, reviews the legal sources, both authoritative and persuasive, that are utilized in analyzing the issues outlined above. Chapter 2 also explains the U.S. federal system in some detail.

Chapter 3 presents the prior attempts to address tax evasion, not through anti-tax evasion measures, but through drafting a blacklist or definitional criteria which "*qualified*" certain jurisdictions as a tax haven jurisdiction. First, the chapter looks briefly at the background on tax havens in general and delves into how there have been attempts to draft substantive criteria in order to have a tax haven definition. This

subsection discusses the blacklist concept and what that has looked like as well as the problems that it presents. Following the examination of definitions and blacklists, the chapter explores the United States' unofficial exercise in identifying tax havens via a blacklist or definition. This section will look at past legislation, various IRS documents and GAO reports that include a blacklist or a definition. Finally, the chapter considers what the real issue is, and what it seems the U.S. has concluded which is that the true problem is the secrecy laws in foreign jurisdictions that allow U.S. taxpayers to conceal their foreign accounts which in turn frustrates the IRS' attempts to administer the tax laws fairly and equitably among all taxpayers.

Taking in consideration that Chapter 3 concludes that secrecy is the real dilemma that thwarts the IRS' attempts at procuring information on U.S. taxpayers' foreign accounts, Chapters 4 through 9 then describe the anti-tax evasion measures that the U.S. has taken to procure the taxpayers' information on their foreign accounts abroad. In each chapter, and via legal dogmatics, the first two questions will be addressed through stating the measure that has been enacted or created to try to procure the taxpayer information on foreign accounts and then describing and analyzing the implementation (or how the measure is carried out) of said measure. The chapters will end by answering the third and fourth questions which ask respectively whether the measure itself allows the IRS to procure information on U.S. taxpayer accounts and if the measure does not, what can be done to increase the IRS' chances of procuring the information needed. The next few paragraphs will describe the subject of each chapter.

Chapter 4 analyzes the Report of Foreign Bank and Financial Accounts which is an anti-tax evasion measure that requires a U.S. person to "voluntarily", subject to penalties and possible jail time for non-compliance, disclose their foreign accounts to the U.S. government. The chapter establishes whether this anti-tax evasion measure fulfills the purpose of procuring information on taxpayers' foreign accounts that the U.S government needs so the IRS can fairly administer the tax laws.

Chapter 5's topic is the voluntary disclosure programs which are anti-tax evasion measures that also rely on voluntary compliance by the taxpayer. This chapter analyzes the various programs, its penalties and a couple of the alternatives to the program to determine if this specific measure operates in a way to procure information on U.S. taxpayers' foreign accounts.

Chapter 6 moves past reliance on voluntary compliance and moves into utilizing the court system and third parties to try to obtain the information on taxpayers' foreign accounts. This chapter analyzes the John Doe Summons – which is a procedure that the U.S government uses when there is an unknown person, in this case a taxpayer, that is suspected of tax evasion – and whether the Summons procedure allows the IRS to obtain the taxpayer information they need.

Chapter 7 also utilizes third parties to help in procuring taxpayer information but this time this assistance comes from foreign financial institutions by way of the Qualified Intermediary regulations (or the QI Agreement if executed by the foreign financial institution).

Chapter 8 analyzes the use of treaties and tax information exchange agreements and how they operate in order to obtain taxpayer information on foreign accounts. Instead of relying on the individual taxpayer or a third party, treaties and tax information exchange agreements rely on the relationships and agreements between the U.S. and foreign governments. A case study is presented in this chapter, the U.S. – Swiss Treaty, in order to demonstrate the difficulties in procuring the information needed through this avenue.

Chapter 9 analyzes the Foreign Account Tax Compliance Act (FATCA) which once again relies on foreign financial institutions to provide information on taxpayers' foreign accounts, however, this time there is an enforcement mechanism attached that forces the foreign financial institution to choose between two options: either comply or face a 30% penalty on any income payments coming from the U.S. To alleviate some of the issues this ultimatum posed, intergovernmental agreements

were created. This chapter also describes and analyzes these agreements to ascertain if they are effective in aiding FATCA in procuring information on U.S. taxpayers' foreign accounts.

Each chapter presents a part of the U.S. government's overall response to the inability to procure U.S. taxpayers' information on foreign accounts and encourage compliance with the tax laws.

CHAPTER 2. LEGAL SOURCES & THE FEDERAL SYSTEM

2.1. INTRODUCTION TO THE U.S. FEDERAL SYSTEM

In order to accomplish an examination and analysis of the anti-tax evasion measures that the U.S. takes in order to procure U.S. taxpayer information on foreign accounts and whether the measures, when implemented, can obtain the information sought, an explanation of the framework of legal sources is required. Considering the thesis is from an American legal perspective, legal sources from the United States are applied and, therefore, an introductory description of the American legal system is needed so that the reader may recognize the importance of the resources chosen and the hierarchy that structures the importance of those resources.

The U.S. legal framework is a federal system which is designed to have two parallel governments - state and federal (national).[126] Both the federal and state governments are based on constitutions and statutory law. The legal sources, therefore, consist of both case law from the federal and state levels as well as (but not limited to) statutes, restatements, legislation, legislative history and regulations. While historically

[126] Bureau of International Information Programs, United States Department of State, *Outline of the U.S. Legal System* (2004), available at https://usa.usembassy.de/etexts/gov/outlinelegalsystem.pdf; See also, Gretchen Feltes, *A Guide to the U.S. Federal Legal System*, found at http://www.nyulawglobal.org/globalex/United_States.html#_A._The_Structure_of%20the%20Federal%20Gov

considered a pure common law system, it can be argued that, today, the United States legal framework consists of a hybrid system of case law and statutory law.[127]

The apportionment of power between the federal government and the states is an important part of the U.S. legal structure and it aids in the determination of which sources are mandatory versus those that are merely persuasive. When considering which legal sources to apply, another critical issue that presents itself is to be able to identify and analyze the correct resources from the applicable jurisdiction. Since it is the purpose of this dissertation to examine what anti-tax evasion measures the U.S. federal government has taken in order to address the inability to obtain taxpayer information on their foreign accounts and whether these anti-tax evasion measures, when implemented, obtain the information sought, it is necessary to only consider legal resources at the federal level.

To understand how to utilize and analyze the legal resources in the U.S., one must have knowledge of the U.S. federal framework and the various sources of law found in that framework and the hierarchy of those sources. The United States' highest source of law is the Constitution which lays out the legal foundation for the United States. While the Constitution is the legal framework, it is a structure of limited, delegated powers delineating the powers between not just the federal and the state level but also three branches of government.[128] The Framers of the Constitution also chose to delineate federal powers into the three separate branches of government: Executive, Legislative and Judicial.[129] The Legislative and Judicial branches will be discussed in more depth in the sections below with regard to the legal resources that each branch has while the Executive branch will be mentioned briefly in reference to

[127] E. Allan Farnsworth, *An Introduction to the Legal System of the United States*, Oxford University Press (2010).
[128] Advisory Commission on Intergovermental Relations, *State Constitutions in the Federal System: Selected Issues and Opportunities for State Initiatives* (July 1989); *See also*, Bureau of International Information Programs, United States Department of State, *Outline of the U.S. Legal* System (2004), *available at* https://usa.usembassy.de/etexts/gov/outlinelegalsystem.pdf.
[129] U.S. Const. art. I, II and III; *See also*, Bureau of International Information Programs, United States Department of State, *Outline of the U.S. Legal* System (2004), *available at* https://usa.usembassy.de/etexts/gov/outlinelegalsystem.pdf

the executive agency[130], the Internal Revenue Service (IRS) Regulations and other IRS resources. The Framers also included the Supremacy Clause which states that the Constitution and the laws of the federal government "*shall be the supreme law of the land*".[131] This means if a state law conflicts with a federal law on the same issue, the federal law will always prevail (unless the federal law is unconstitutional).

Although the Constitution gives priority to itself and the federal laws, the Bill of Rights limits the power of the federal government by stating that where the powers are not specifically delegated to the federal government those powers fall to the state governments – for example, family law.[132] Knowledge of the two parallel systems and how they complement each other is important because when a legal issue is being researched in the United States, both the federal and the state level laws have to be considered in order to conclude whether a federal or state issue is present. Then based on that analysis it can be determined which resources should be applied.

An example of the dichotomy between the states and federal government is taxing power because the taxing power is split between the federal government and the state governments. The federal government has no limit to the taxing power it contains except as limited by the Constitution.[133]

Additionally, important in the American legal doctrine is the hierarchal nature of the laws and how they are ordered and applied which will be discussed throughout this chapter. To understand how the legal dogmatic method functions in the American common law system, it is important to consider the structure of the U.S. system and its hierarchal structure. Therefore, to assist with this goal, this chapter starts with the most authoritative sources of law and ends with the least authoritative sources of law - persuasive, non-mandatory sources.

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[130] This thesis deals mainly with the Department of the Treasury, an executive agency, and its sub-agencies like the IRS and FinCEN.
[131] U.S. Const., art. VI §2
[132] U.S. Const. amend. X
[133] William Cogger, *Tax Avoidance v. Tax Evasion*, 15 Tax Mag. 518 (1937).

2.2. TREATIES AND INTERNATIONAL AGREEMENTS

As Justice Sonia Sotomayor declared during her Senate Judiciary Committee confirmation hearing, "*American law does not permit the use of foreign law or international law to interpret the Constitution*."[134] Justice Sotomayor is, of course, correct that foreign or international laws cannot help interpret the Constitution, nonetheless, treaties and international agreements do have a place in the American legal system.

The Constitution of the United States provides the President with the authority to make and negotiate treaties while giving Congress the authority to ratify any treaties made by the Executive branch in Article II, Section 2, Clause 1:

> "*He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur;"*[135]

The Supremacy Clause in the U.S. Constitution gives treaties the same level of authority as the Constitution and the laws of the United States:

> *"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in*

[134] Ted Cruz, *Limits on the Treaty Power*, 127 Har. L. Rev. F. 93 (Winter 2014) *found at* https://harvardlawreview.org/2014/01/limits-on-the-treaty-power/

[135] U.S. Const. art. II, §2, cl. 2; *See also*, Paul R. McDaniel, James R. Repetti and Diane M. Ring, *Introduction to United States International Taxation*, 187 (6th ed., 2014).

> *the Constitution or Laws of any State to the Contrary notwithstanding."*[136]

When a statute and a treaty come into conflict with one another, the question that arises is which one prevails, the treaty or the statute? The general rule is that a later law abrogates an earlier law and since treaties are on the same authority level as statutes, the same principle applies to treaties and statutes.[137] Accordingly, a treaty that comes later than a statute would nullify that statute and vice versa.

Since the issues that this thesis analyzes are within the area of tax law, this thesis analyzes and references various tax treaties. There are two categories of tax treaties: Self-executing and non-self-executing.[138] A self-executing treaty is one that has automatic effect as domestic law.[139] According to the holding in *United States v. Percheman*, a treaty is equal to an act of the legislature and, consequently, is self-executing when it does not require any legislation provision to aid it and which can be enforced by the courts.[140] In contrast, a non-self-executing treaty is defined as a treaty that is ratified with the agreement that the treaty does "not have domestic effect of its own force and cannot be judicially enforced without the implementing legislation."[141] These types of treaties are merely international law commitments but

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[136] U.S. Const. art. VI, §2
[137] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 528 (3rd ed. 2011); *See also*, Paul R. McDaniel, James R. Repetti and Diane M. Ring, *Introduction to United States International Taxation*, 187 (6th ed., 2014).
[138] Ted Cruz, *Limits on the Treaty* Power, 127 Har. L. Rev. F. 93 (Winter 2014) *found at* https://harvardlawreview.org/2014/01/limits-on-the-treaty-power/
[139] *Medellin v. Texas*, 552 U.S. 491 (2008); *See also*, Ted Cruz, *Limits on the Treaty Power*, 127 Har. L. Rev. F. 93 (Winter 2014) *found at* https://harvardlawreview.org/2014/01/limits-on-the-treaty-power/
[140] *United States v. Percheman*, 7 Pet. 51, 8 L.Ed. 604 (1833) as quoted in *Medellin v. Texas*, 552 U.S. 491, 504 (2008); *See also*, Cornell Legal Information Institute, Self-Executing Treaty, law.cornell.edu/wex/self_executing_treaty
[141] *Medellin v. Texas*, 552 U.S. 491 (2008); *See also*, Ted Cruz, *Limits on the Treaty Power*, 127 Har. L. Rev. F. 93 (Winter 2014) *found at* https://harvardlawreview.org/2014/01/limits-on-the-treaty-power/

they do not create binding federal law unless Congress enacts an implementing statute or ratifies the treaty with a provision that provides for it to be self-executing.[142]

There is a body of case law that provides interpretive guidelines to help in the interpretation of a treaty.[143] As with a statute, the interpretation of a treaty starts with the text itself.[144] The Supreme Court noted that considering a treaty is an agreement between sovereign nations, the negotiations, drafting history and the post-ratification understanding of signatory nations should be used as aids to the interpretation of the treaty in question.[145]

When there is a potential conflict between an earlier treaty or statute and a later document the court will first explore whether there is an actual conflict.[146] The Court initially presumes that both the earlier and later document are in harmony.[147] Courts try to construe in order to give effect to both documents unless it violates the language of one or the other.[148] If there was intent to abrogate or modify that intention should be clearly expressed.[149] If there is an actual conflict between an earlier treaty or statute and a later one, the court will hold that the later one prevails.[150] However, in the more recent past, to make its intent clear, Congress has specifically included in its

[142] *Medellin v. Texas*, 552 U.S. 491 (2008), *quoting Igartua-De La Rosa V. United States*, 417 F.3d 145, 150 (C.A.1 2005) (en banc).
[143] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 527 (3rd ed. 2011).
[144] *Air France v. Saks*, 470 U.S. 392 (1985) as quoted by *Medellin v. Texas*, 552 U.S. 491 (2008).
[145] *Zicherman v. Korean Air Lines Co.*, 516 U.S. 217 (1996) as quoted by *Medellin v. Texas*, 552 U.S. 491 (2008).
[146] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 527 (3rd ed. 2011).
[147] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 527 (3rd ed. 2011).
[148] *Whitney v. Robertson*, 124 U.S. 190 (1888); *See also*, Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 527 (3rd ed. 2011).
[149] *Cook v. United* States, 288 U.S. 102 (1933); *See also*, Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 528 (3rd ed. 2011).
[150] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 528 (3rd ed. 2011).

legislation that it intended the "later-in-time rule" to apply so that the statutes within the tax legislation would prevail over treaties.[151]

Treaties will be discussed in more depth and specifically art. 26 of the U.S. Model Income Tax Treaty in relation to the thesis focus in Chapter 8.

2.3. STATUTORY LAW

While the U.S. has the three branches of government that share power equally, statutory law is one of the most authoritative sources of law, just below the Constitution and on par with treaties. When examining and analyzing statutory law, the source to refer to is the legislative branch and its legal sources. Within the U.S. federal system, the Constitution vested power to enact laws in Congress, which is a bicameral structure that has two chambers: the House and Senate.[152] The legislative process starts with an introduction of a bill to either the House or the Senate (or there can be parallel bills introduced in both Chambers). The next step in the process is a referral to an appropriate committee such as the Senate Joint Committee on Taxation or the House Ways and Means Committee which oversees the specific policy area that is the focus of the bill that has been introduced.[153] It is first examined in a subcommittee and if the committee members agree, it moves on to the full committee.[154] If the full committee approves the bill, it then moves to the floor of the House or Senate where it is placed on the calendar for consideration. If the bill does

[151] Reuven S. Avi-Yonah, Diane M. Ring and Yariv Brauner, *U.S. International Taxation: Cases and Materials*, 528 (3rd ed. 2011).
[152] U.S. Const. art. I, §1; *See also*, Larry M. Eig, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service Report (September 24, 2014).
[153] White House, *The Legislative Branch*, *found at* https://www.whitehouse.gov/1600/legislative-branch; *See also*, Portland State University Library, *United States Government Information: Congress: House and Senate*, *found at* http://guides.library.pdx.edu/c.php?g=271192&p=1811800
[154] White House, *The Legislative Branch*, *found at* https://www.whitehouse.gov/1600/legislative-branch; *See also*, Portland State University Library, *United States Government Information: Congress: House and Senate*, *found at* http://guides.library.pdx.edu/c.php?g=271192&p=1811800

not move out of the committee onto the floor of either the House or Senate, then the bill is considered to have "died" in committee.[155] When the bill has made its way to either the House or the Senate there is a floor debate[156]. A floor debate means the bill is presented back to the appropriate chamber of Congress and is opened up for amendments, alterations and statements from members of said chamber.[157] If similar bills are introduced and passed in both chambers of Congress, then a committee - called a Conference Committee - is formed in order to reconcile the differences between the two bills. The amended bill is then reintroduced to both chambers and voted on.[158] In order to enact a bill, a simple majority of votes is needed, but it must be ratified by both houses of Congress. The legislation then goes to the President who has the three choices: sign the bill into law, veto the bill or take no action on the bill. If the President chooses to take no action - meaning it is not executed and returned within 10 days - then it automatically becomes law (unless Congress has adjourned which makes it impossible for the signed bill to be returned).[159] This last action is called a pocket veto.[160] If the President elects to veto the legislation, Congress can override his decision by a two-thirds vote in each chamber of Congress. Once enacted, it becomes part of the United States Code (hereinafter referred to as USC). Based on the above process, it is necessary to consider in this thesis the legislative history, if any, and the political background that preceded the passage of the anti-tax evasion

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[155] Duke University Libraries, *Legislative Process: Committee Analysis*, https://guides.library.duke.edu/c.php?g=289725&p=1930930

[156] Duke University Libraries, *Legislative Process: Committee Analysis* https://guides.library.duke.edu/c.php?g=289725&p=1930930

[157] White House, *The Legislative Branch, found at* https://www.whitehouse.gov/1600/legislative-branch;*See also,* Portland State University Library, *United States Government Information: Congress: House and Senate, found at* http://guides.library.pdx.edu/c.php?g=271192&p=1811800; Duke University Libraries, *Legislative Process: Committee Analysis, found at* https://guides.library.duke.edu/c.php?g=289725&p=1930927

[158] Duke University Libraries, *Legislative Process: Committee Analysis, found at* https://guides.library.duke.edu/c.php?g=289725&p=1930927,

[159] White House, *The Legislative Branch, found at* https://www.whitehouse.gov/1600/legislative-branch; *See also,* Portland State University Library, *United States Government Information: Congress: House and Senate, found at* http://guides.library.pdx.edu/c.php?g=271192&p=1811800

[160] U.S. Const. art. I, §7, cl. 5; *See also,* U.S. Senate, *Pocket Veto,* https://www.senate.gov/reference/glossary_term/pocket_veto.htm

statutes that are discussed in this thesis as it may shed light on the form and phrasing of the statutes analyzed.

For this dissertation the most important statutory source which is found in Chapter 26 of the USC which is the U.S. tax code. The Code of Federal Regulations (hereinafter referred to as CFR), which is an executive legal resource (executive branch resources are discussed more in section 2.6) is the interpretative aide to the tax code which is also numbered chapter 26. The CFR, a form of administrative law, is the codification of the "*general and permanent rules published in the Federal Register by the departments and agencies of the Federal government*"[161] such as the Department of the Treasury sub-agency, the IRS. The CFR is the regulatory agency's guidelines on how the statutes should work in reality. When a statute and regulation conflict, courts have held that the statute prevails over the regulation.[162]

There are multiple resources that aid in the interpretation of the statute in addition to the CFR (however, the other sources are merely persuasive). When the bill goes through the legislative process, unless it dies in committee, there is legislative history to help understand and interpret the statute.[163] Legislative history will be discussed further in the next section.

The natural question to ask at this juncture is how does one interpret U.S. statutes? Generally, the U.S. follows the plain meaning rule which essentially states that the meaning of the statute must be found in the language within the statute.[164] "*Where the language is plain and admits of no more than one meaning, the duty of interpretation*

[161] Code of Federal Regulations, https://bookstore.gpo.gov/catalog/code-federal-regulations-cfrs-print; *See also*, Code of Federal Regulationshttps://www.govinfo.gov/help/cfr
[162] Hale E. Sheppard, E*volution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 21 (2006) (citing *Caldera v. J.S. Alberici Const. Co., Inc*., 153 F.3d 1381, 1383 (Fed. Cir. 1998).
[163] See more in section 2.4 immediately following
[164] *U.S. v. Wiltberger*, 18 U.S. 76 (1820); *See also*, *Caminetti v. U.S*., 242 U.S. 470 (1917), *Barnhart v. Sigmon Coal Co., Inc*., 534 U.S. 438 (2002); Larry M. Eig, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service Report (September 24, 2014).

does not arise….."[165] The words in the statute should be given their ordinary and usual meaning unless there is evidence to the contrary.[166] So unless the language in the statute is somehow ambiguous or confusing, other information, including legislative intent, cannot be taken into consideration. Notwithstanding the plain meaning rule, there is some controversy that surrounds the issue of when to use legislative history to help interpret or when to allow the language used to speak for itself, however, that will not to be discussed in this thesis as it is not within the scope.[167]

Despite the controversy, the plain meaning principle is the general rule that is used to help interpret statutory language and there are two exceptions to this principle. The first exception exists when the result of reading the plain meaning would result in an absurd result which would shock either the common or moral sense.[168] The second exception occurs when the literal application of the statutory language generates an outcome that is in opposition to the legislative intent.[169] Knowing this, it is relevant to consider the legislative intent with regard to the appropriate statutes (and Acts) and a discussion on legislative history follows in the next section.

2.4. LEGISLATIVE HISTORY

Legislative history for statutes passed at the federal level, while not mandatory, is a persuasive source of law because it can present the purpose and the rationale behind the law and the words chosen. Some legislators, in introductory statements when presenting the bill, will specifically address the purpose and reasons behind the law

[165] *U.S. v. Wiltberger*, 18 U.S. 76 (1820); See also, *Caminetti v. U.S*., 242 U.S. 470 (1917); *Barnhart v. Sigmon Coal Co., Inc*., 534 U.S. 438 (2002).
[166] *U.S. v. Wiltberger*, 18 U.S. 76 (1820); *See also, Caminetti v. U.S*., 242 U.S. 470 (1917); *Barnhart v. Sigmon Coal Co.*, Inc., 534 U.S. 438 (2002).
[167] Larry M. Eig, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service Report, 43 (September 24, 2014).
[168] *In re Sunterra Corp*., 361 F.3d 257 (4th Cir. 2004); *See also, Sigmon Coal v. Apfel*, 226 F.3d 291 (4th Cir. 2000), aff'd, *Barnhart v. Sigmon Coal Co*., 534 U.S. 438 (2002).
[169] *In re Sunterra Corp*., 361 F.3d 257 (4th Cir. 2004); *See also, Sigmon Coal v. Apfel*, 226 F.3d 291 (4th Cir. 2000), aff'd, *Barnhart v. Sigmon Coal Co*., 534 U.S. 438 (2002).

to help to guide the courts in interpretation. Legislative history plays an important part in understanding the statutes and acts that are enacted because legislative intent can help interpret the law so as to give meaning to vague and ambiguous terms as well as reveal the motivation and purpose behind the law. The history of a piece of legislation can affirm the legislative intent of Congress. As a result of the very political nature of the issue of tax evasion, tax havens and anti-tax evasion measures, drafting history (where it can be found) is important for this dissertation because the legislation can be affected by political opinions on both sides of the congressional aisle. For example, at the federal level there is a definite demarcation between which party drafts and supports tax haven-focused legislation (democrats) and which party does not (republicans).[170]

Transcripts of congressional hearings and introductory remarks are examined in this thesis as an important, persuasive source of pre-legislation information about the views on tax evasion and secrecy from the various congressional bodies (such as the congressional committees), individual Congressman and witnesses. While only persuasive in nature, the congressional hearings give insight into the motivations and purposes behind the passage of the anti-tax evasion measures discussed in this dissertation. The two committees within Congress that deal with legislative tax issues are the Senate Finance Committee and the House Ways and Means Committee.[171] The Constitution, under Article I, Section VII, gives the House of Representatives

[170] Most tax haven-specific legislation is authored and co-authored by the Democratic members of Congress such as Senator Levin. See Chapter 3 for a discussion of past legislation attempts on tax haven definition legislation.
[171] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-6 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

jurisdiction over "*all the Bills for raising revenue*".[172] When the legislative history is in conflict with the statute, courts have held that the statute prevails.[173]

Another legal source to consider for legislative material is the Joint Committee for Taxation (hereinafter referred to as the JCT). The JCT was established under the Revenue Act of 1926 in order to assist Congressional members on tax legislation.[174] This non-partisan committee is composed of five House members from the Ways and Means committee and five Senate members from the Senate Finance committee.[175] There are three members from the majority party and two members from the minority members from each committee.[176] The staff of the JCT that support and assist members of Congress is comprised of economists, attorneys and accountants.[177]

The tasks of the JCT, as statutorily prescribed, are multi-fold: "to investigate the operation and effects of internal revenue taxes and the administration of such taxes, to investigate measures and methods for the simplification of such taxes, to draft reports that are submitted to the House Ways and Means Committee and the Senate Committee on Finance on the results of such investigations and studies and to make recommendations and to review any proposed refund or credit of income or estates and gift taxes or certain other taxes set forth in Internal Revenue Code (IRC) §6405 in excess of $2 million USD".[178] The JCT is also given jurisdiction to "*obtain and*

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[172] U.S. Const. art. I, §7, *See also,* House Ways and Means Committee, *About Us, found at* https://waysandmeans.house.gov/about/

[173] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 37 (2006) (citing *Strom v. Goldman, Sachs & Co.*, 202 F.3d 138, 145 (2d Cir. 1999), *Abourezk v. Reagan*, 785 F.2d 1043, 1055 (D.C. Cir. 1986), *Sharp v. United States*, 27 Fed. Cl. 52, 61 (1992), *aff'd*, 14 F.3d 583 (1993)).

[174] The Joint Committee on Taxation, *About Us: Overview*, https://www.jct.gov/about-us/overview.html

[175]The Joint Committee on Taxation, *About Us: Statutory Basis*, https://www.jct.gov/about-us/statutory-basis.html; *See also,* Senate Finance Committee, *Jurisdiction, found at* https://www.finance.senate.gov/about/jurisdiction

[176] The Joint Committee on Taxation, *About Us: Overview*, https://www.jct.gov/about-us/overview.html

[177] The Joint Committee on Taxation, *About Us: Current Staff*, https://www.jct.gov/about-us/current-staff.html; *See also,* The Joint Committee on Taxation, *About Us: Overview*, https://www.jct.gov/about-us/overview.html

[178] The Joint Committee on Taxation, *About Us: Statutory Basis*, https://www.jct.gov/about-us/statutory-basis.html

inspect tax returns and return information, hold hearings, require attendance of witnesses and production of books, administer oaths and take testimony, procure printing and binding and make necessary expenditures."[179] They are also required by statute to provide revenue estimates for all tax legislation that is submitted to either congressional chamber.[180]

The JCT also is also involved in the legislative process from beginning to end.[181] The JCT staff helps congressional members throughout the legislative process in ways such as (but not limited to) preparation for introducing bills into either chamber, being involved in the markup process including describing legislative proposals to the committee and consulting with Treasury and the IRS.[182] The JCT is also the only archive that contains the complete legislative history on Federal Taxation.[183]

Government Accounting Office (hereinafter GAO) reports are another non-mandatory but persuasive legal source. These reports are usually initiated at the request of a member of Congress or sometimes a committee and are on various topics.[184] The GAO, which is a part of the legislative branch, can also self-initiate reports.[185] The mission of the GAO, as provided at the back of each report, is "*to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy and funding decisions. GAO's commitment to good government is reflected in*

[179] The Joint Committee on Taxation, *About Us: Statutory Basis*, https://www.jct.gov/about-us/statutory-basis.html
[180] The Joint Committee on Taxation, *About Us: Statutory Basis*, https://www.jct.gov/about-us/statutory-basis.html
[181] The Joint Committee on Taxation, *About Us: Role of JCT*, https://www.jct.gov/about-us/role-of-jct.html
[182] The Joint Committee on Taxation, *About Us: Role of JCT*, https://www.jct.gov/about-us/role-of-jct.html
[183] The Joint Committee on Taxation, *About Us: Other*, https://www.jct.gov/about-us/other.html
[184] GAO, *About GAO Reports*, https://www.gao.gov/about/products/about-gao-reports.html
[185] GAO, *About GAO Reports*, https://www.gao.gov/about/products/about-gao-reports.html

its core values of accountability, integrity and reliability."[186] The GAO's website asserts that the information it provides is non-partisan and fact-based.[187]

A similar government service to that of the GAO's is the CRS, or Congressional Research Service (hereinafter referred to as CRS), which is the legislative branch department of the Library of Congress.[188] The Library of Congress is not only the world's largest library but it also acts as the "*main research arm of the U.S. Congress*."[189] The CRS, according to the website, "*works exclusively for the United States Congress, providing policy and legal analysis to committees and Members of both the House and Senate, regardless of party affiliation*".[190] The CRS also claims that the information they provide is non-partisan and objective.[191]

2.5. CASE LAW AND THE DOCTRINE OF *STARE DECISIS*

The second branch, and second legal source, of the U.S. government is the judicial branch. The role of the judicial branch in the U.S. is multi-fold and is distinguished from civil law jurisdictions. Common law was originally known as "judge-made law" because there was no statutory law at the time. Today, however, the job of the courts is to interpret the law, decide constitutionality of the law, and resolve disputes by applying the law.[192]

[186] GAO, *Taxpayer Information: Data Sharing and Analysis May Enhance Tax Compliance and Improve Immigration Eligibility Decisions*, GAO-04-972T (July 2004).
[187] Government Accountability Office, *What GAO Does, found at* https://www.gao.gov/about/what-gao-does/
[188] Library of Congress, *CRS Info, found at* https://www.loc.gov/crsinfo/
[189] Library of Congress, *found at* https://www.loc.gov/about/
[190] Library of Congress, *CRS Info, found at* https://www.loc.gov/crsinfo/
[191] Library of Congress, *CRS Info, found at* https://www.loc.gov/crsinfo/
[192]United States Courts, *Court Role and Structure, found at* https://www.uscourts.gov/about-federal-courts/court-role-and-structure

Over the young life of the United States, the important legal doctrine of *stare decisis et non quieta movere*[193], a legal remnant leftover from the influence of English common law[194], has emerged as a part of American judicial interpretation. *Stare decisis et non quieta movere* literally means to abide by the precedents and to not disturb settled points.[195] Essentially, this means that courts are bound by earlier legal decisions and they are to interpret the law in the same way as higher courts have in past cases.[196] Another way to say this is that earlier cases from higher courts have set a *precedent* that later judges are to follow. Previous cases from the same court are also precedent as well. For example, a prior 2nd Court of Appeals decision would be considered precedent for a present 2nd Court of Appeals case.

This is important depending on what jurisdiction one is in and which court they must follow. The U.S. Federal system contains 94 District Courts (trial courts), 13 Courts of Appeal (also called circuit or appellate courts) and the Supreme Court, which is the highest court in the United States.[197] The U.S.' 94 trial districts are broken up into 12 regional circuits in which a court of appeals sits.[198] Therefore, what case law one refers to as binding (mandatory) as opposed to persuasive depends on which circuit one is in. *"The doctrine of stare decisis, or adherence to precedent, requires courts to decide cases consistently with their past decisions involving the same or similar facts and legal principles. Lower courts in a particular jurisdiction are bound not only by their own past decisions, but also by the precedents of higher courts in that jurisdiction."*[199]

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[193] H. Campbell Black, *The Principle of Stare Decisis*, 34 U. Pa. L. Rev. 745 (Dec. 1886).
[194] Konrad Zweigert, *An Introduction to Comparative Law*, 260 (Clarendon Press, 3rd ed., 1998).
[195] H. Campbell Black, *The Principle of Stare Decisis*, 34 U. Pa. L. Rev. 745 (Dec. 1886).
[196] Larry M. Eig, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service Report, 1 (September 24, 2014).
[197] U.S. Courts, *Court Role and Structure*, http://www.uscourts.gov/about-federal-courts/court-role-and-structure
[198] Allan E. Farnsworth, *An Introduction to the Legal System of the United States*, p. 60, Oxford University Press (2010).
[199] J. Paul Lomio, Henrik S. Spang-Hanssen and George D. Wilson, *Legal Research Methods in a Modern World: A Coursebook*, p 84 (Djøf Publishing, 2011).

For example, if a case being heard occurs in Dallas, Texas, the case would be heard in the Northern District of Texas (United States District Court) which is bound by any decision out of the 5th Circuit Court of Appeals, which sits in New Orleans, Louisiana and, of course, the Supreme Court. Case law from other jurisdictions can be persuasive but never binding. Therefore, the case being heard in the Northern District of Texas is required to follow, based on the principle of *stare decisis,* prior case law from itself, the 5th Circuit Court of Appeals and the Supreme Court.

The state court system has a similar structure. There are trial courts, appellate courts and supreme courts of each state, however, the trial courts and their jurisdictions vary widely in each state[200]. At least one state has a division at the Supreme Court level. Texas has a divided supreme court: one that has jurisdictions over civil cases and cases regarding juveniles and criminal cases on appeal are heard by the Court of Criminal Appeals.[201] Once a decision has been reached at the state supreme court level, the decision can be appealed to the U.S. Supreme Court on a Writ of Certiorari as long as there is a federal issue in question[202] but the Supreme Court rarely hears these types of cases. The principle of *stare decisis* is also followed at the state level.

Another crucial point to note is that in certain areas of law, both state and federal courts can share power (concurrent powers). This means the plaintiff can file suit in either a federal court or a state court. The courts at both levels then may have to, depending on the claim, apply the applicable state law in a federal court or federal law in a state court.

2.5.1. COURT JURISDICTION OF TAX ISSUES

This thesis' focus falls under U.S. tax law, therefore, it is important to recognize which U.S. courts have jurisdiction over tax issues. When the commissioner of the IRS finds

[200] Comparing Federal and State Courts, https://www.uscourts.gov/about-federal-courts/court-role-and-structure/comparing-federal-state-courts
[201] Texas Courts, *Court Structure Chart*, http://www.txcourts.gov/media/1438758/court-structure-chart-sept-2017.pdf
[202] Comparing Federal and State Courts, https://www.uscourts.gov/about-federal-courts/court-role-and-structure/comparing-federal-state-courts

that a U.S. taxpayer has a tax deficiency (or liability), the taxpayer can dispute this in court. Four courts have jurisdiction over tax disputes: U.S. Bankruptcy Court, U.S. Court of Federal Claims, U.S. District Courts and U.S. Tax Court. The U.S. Bankruptcy court only has jurisdiction over tax issues when they arise within a bankruptcy case.[203] Both the U.S. Court of Federal Claims and the U.S. District Courts hear a wide variety of cases including tax disputes.[204] While the U.S. Court of Federal Claims has more experience, than the U.S. District Court(s) in tax law, neither have the experience that the U.S. Tax Court has.[205] These courts are all federal trial courts.

The U.S. Tax Court is the most relevant court to this thesis because it is a specialized court that only hears federal tax cases.[206] The U.S. Tax Court is a special court established by Congress under Art. I of the U.S. Constitution.[207] It was established to hear disputes between U.S. taxpayers and the Internal Revenue Service (IRS).[208] When litigating a tax dispute in the U.S. Tax Court, a taxpayer does not have to pay the disputed amount before bringing the issue before the court and until all appeals are concluded. This is in contrast to the other courts who have jurisdiction to hear tax issues – the taxpayer who litigates issues in those courts has to pay the disputed

[203] Franklin County Law Library, *Tax Law Research: Federal and Ohio: Court Jurisdiction of Tax Issues and Appellate Structure, found at* https://fclawlib.libguides.com/taxlawresearch/jurisdiction; *See also,* LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047
[204] Franklin County Law Library, *Tax Law Research: Federal and Ohio: Court Jurisdiction of Tax Issues and Appellate Structure, found at* https://fclawlib.libguides.com/taxlawresearch/jurisdiction; *See also,* LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047
[205] Franklin County Law Library, *Tax Law Research: Federal and Ohio: Court Jurisdiction of Tax Issues and Appellate Structure, found at* https://fclawlib.libguides.com/taxlawresearch/jurisdiction; *See also,* LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047
[206] LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047
[207] U.S. Tax Court, *About, found at* https://www.ustaxcourt.gov/about.htm
[208] U.S. Tax Court, *About, found at* https://www.ustaxcourt.gov/about.htm

amount before bringing the litigation.[209] The party that loses the case – whether it is the taxpayer and or the IRS – has a right, generally, to appeal the decision made by a trial court. A taxpayer can request two different case statuses at the beginning of the litigation which have significant importance for what can occur after the Tax Court's decision. If a taxpayer requests a small tax case status[210], otherwise known as S case status, neither party can appeal the decision as the Judge's decision is final.[211] However, if the taxpayer chooses a regular case status, then the case can be appealed to one of the U.S. Appellate Courts.[212] A decision from an Appellate Court can be appealed to the U.S. Supreme Court. The Supreme Court, however, generally does not decide many tax cases unless there is a constitutional question at issue or the appellate court decisions are split.[213]

2.6. EXECUTIVE BRANCH RESOURCES

The third branch of the government and thus, the third legal resource, is the Executive Branch which consists of the President, Vice-President, the President's cabinet, the executive departments, such as the Department of the Treasury or the Department of Justice, the agencies that are underneath each Department and other various boards, commissions and committees.[214] For this thesis, the resources from the Department of the Treasury as well as its sub-agency, the Internal Revenue Service (IRS) are

[209] U.S. Tax Court, *About, found at* https://www.ustaxcourt.gov/about.htm; *See also*, Franklin County Law Library, *Tax Law Research: Federal and Ohio: Court Jurisdiction of Tax Issues and Appellate Structure, found at* https://fclawlib.libguides.com/taxlawresearch/jurisdiction; LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047

[210] The taxpayer can request either an small tax case status or a regular case status but the Tax Court grants that status.

[211] U.S. Tax Court, *Taxpayer Information: After Trial, found at* https://www.ustaxcourt.gov/taxpayer_info_after.htm#AFTER6

[212] U.S. Tax Court, *Taxpayer Information: After Trial, found at* https://www.ustaxcourt.gov/taxpayer_info_after.htm#AFTER6; U.S. Courts, *About U.S. Court of Appeals, found at* https://www.uscourts.gov/about-federal-courts/court-role-and-structure/about-us-courts-appeals

[213] LSU Law Library, *Tax Policy and Procedure: Hierarchy of Tax Authorities, found at* https://libguides.law.lsu.edu/c.php?g=191374&p=1264047

[214] U.S. Const., art. II, §1; *See also*, Branches of the U.S. Government, *Executive Branch*, https://www.usa.gov/branches-of-government#item-214500

important Executive branch sources. The purpose of the Executive branch is to conduct and enforce the laws[215] The Executive branch is given its authority under Art. II of the U.S. Constitution. It gives the President the power to, as noted previously, make treaties, and nominate various government roles like ambassadors and judges.

The Executive branch resources that this thesis primarily utilizes are resources from the Department of the Treasury and its subagency, the IRS. The Department of Treasury resources that are referred to and referenced are reports and memos. The multiple resources that are published by the IRS that are utilized in this thesis are publications such as IRS press releases, revenue rulings, announcements, notices and the Internal Revenue Manual (IRM). FinCEN[216], another subagency under the Department of the Treasury, has been put in charge of the Reports of Foreign Bank and Financial Accounts (FBAR). Resources from that subagency are used in Chapter 4 which focuses on the FBAR.

Resources from the Department of Justice, another executive branch agency, are also used and analyzed. For example, DOJ press releases and documents from court cases dealing with John Doe summons (Chapter 6) such as proposed orders are referenced.

Reports, memos, press releases and many of the other resources are not mandatory resources but are merely persuasive in nature.

As noted in Section 2.4, an important executive branch resource is the Code of Federal Regulations (CFR). It is published every year and it contains both the general and permanent rules established by the executive departments and their subagencies.

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[215] Branches of the U.S. Government, *Executive Branch*, https://www.usa.gov/branches-of-government#item-214500

[216] Financial Crimes Enforcement Network is a subagency if the Department of the Treasury whose focus is "to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities." *See* FinCEN, *What We Do*, https://www.fincen.gov/what-we-do

2.7. OTHER SOURCES

One resource that this thesis examines is other scholarly research and books. While these articles and books are not authoritative and merely persuasive in nature, they provide background knowledge, historical information as well as interesting and thought-provoking ideas and viewpoints.

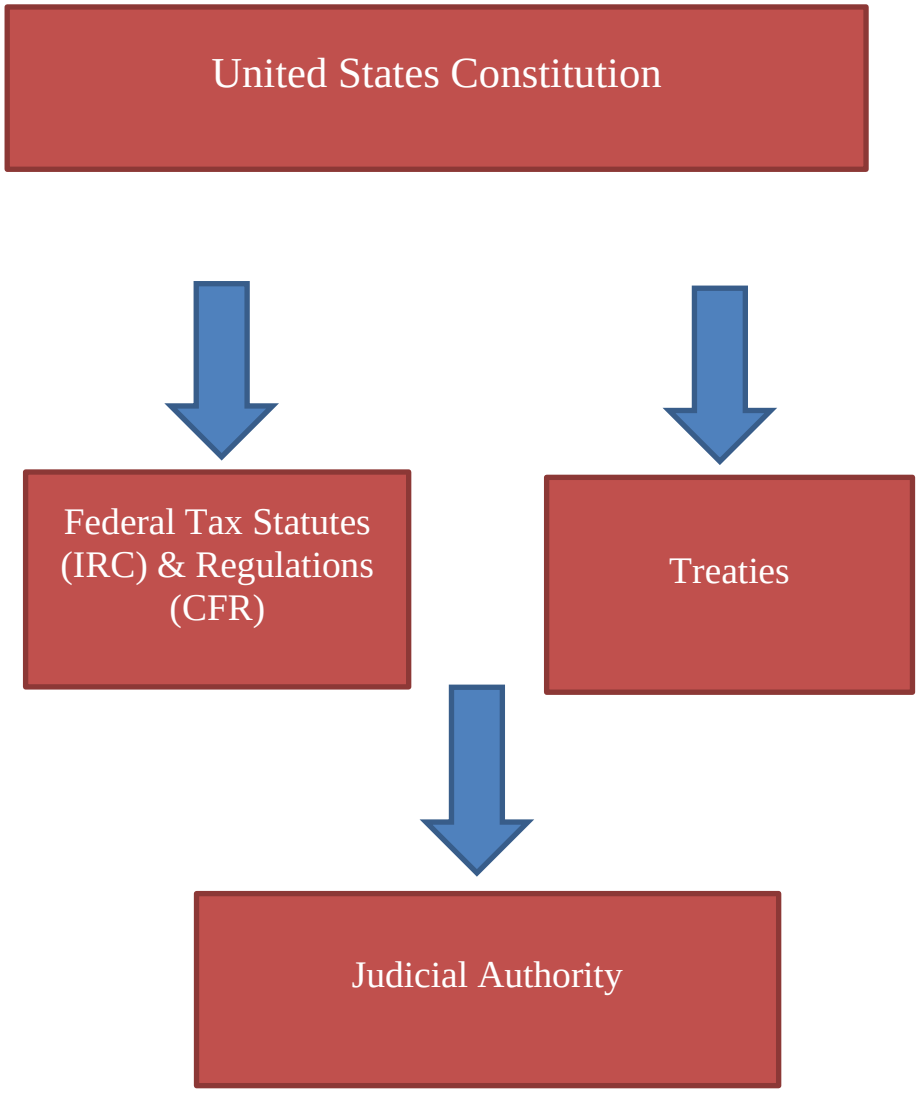
The Tax Justice Network is an "*independent international network*"[217] and advocacy group whose main goal is to sway political issues such financial globalization and tax havens and has been included as a source in this thesis. They claim to have no political association, despite that claim they have been identified as a left-leaning organization.[218] But because the Tax Justice Network and its research is quoted and referred to often throughout the literature in reference to tax evasion, they are being utilized as a source of knowledge on the issues of tax evasion while acknowledging the possible left-leaning viewpoint.

News sites, such as Forbes, Bloomberg and Time, are another non-authoritative, persuasive source that this thesis uses. As can be said for the scholarly articles and books, these websites can provide factual information and data that are applicable to the issues in this thesis. The news sites are used for up-to-date information as well as background information. Some of these news sites can also have a political bias either leaning conservative or liberal.

[217] Tax Justice Network, *Who We Are: Goals*, https://www.taxjustice.net/about/who-we-are/goals/

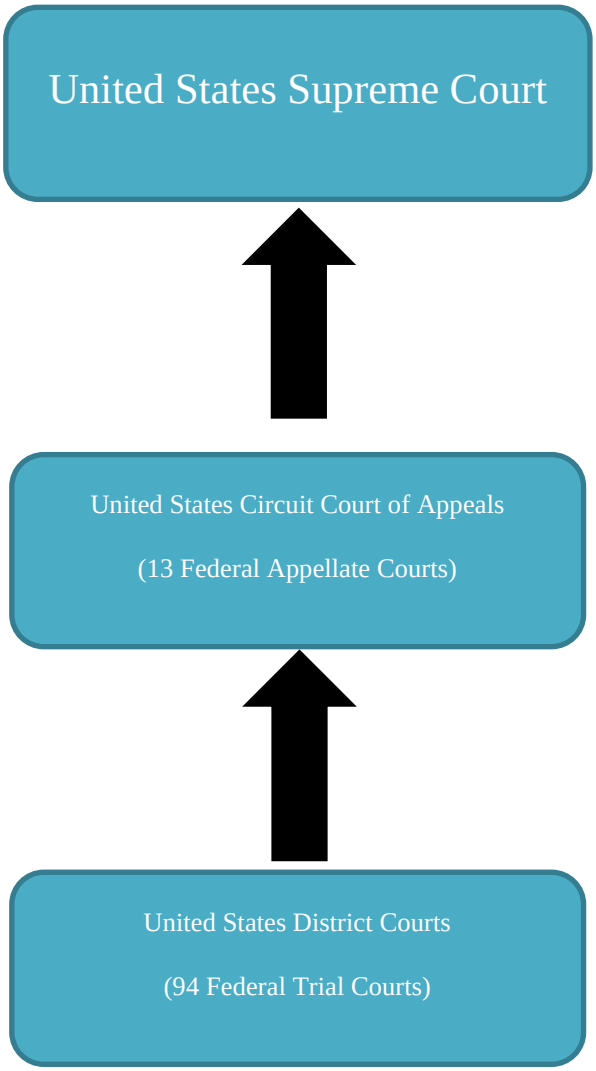
[218] Time, *The Real Problem with Offshore Tax Havens*, http://business.time.com/2012/07/26/the-real-problem-with-offshore-tax-havens/; *See also,* Today Online, *Singapore: World's Fifth Largest Tax Haven,* https://www.todayonline.com/singapore/singapore-worlds-fifth-largest-tax-haven-behind-hk-report, Bloomberg, *U.S. Seen as World's Second Biggest Tax Haven After Switzerland,* https://www.bloomberg.com/news/articles/2018-01-30/u-s-seen-as-world-s-second-biggest-tax-haven-after-switzerland

Hierarchy of Mandatory Tax Law



[219] IRS, https://www.irs.gov/pub/irs-tege/eotopich87.pdf; *See also*, IRS, *Understanding IRS Guidance: A Brief Primer*, https://www.irs.gov/uac/understanding-irs-guidance-a-brief-primer;http://fclawlib.libguides.com/taxlawresearch/hierarchy; http://libguides.uwlax.edu/c.php?g=274077&p=1828557;

Hierarchy of U.S. Federal Courts[220]



[220] U.S. Courts, *Court Role and Structure*, http://www.uscourts.gov/about-federal-courts/court-role-and-structure;*See also*, Department of Justice, *Federal Courts*, https://www.justice.gov/usao/justice-101/federal-courts

2.8. QUICK WORD ON THE HISTORY OF THE U.S. TAX SYSTEM

Since the early days of America – a colonial part of the bigger British Empire - taxes have consistently been a point of contention that has resulted in both an ethical and moral question of whether tax evasion is acceptable. In the early 1700s, the colonists, in order to avoid paying taxes to the British Crown, shifted their trade to the Latin American countries.[221] The British Parliament had passed several tax acts with the purpose of raising revenue which the colonists found unreasonable and, thus, they refused to pay the taxes.[222] Samuel Adams argued at the time that "*It is an essential, natural right, that a man shall quietly enjoy, and have the sole disposal of his own property"*[223] which seemed to be the prevailing view of many American colonists at the time. This created, according to one scholar, a tax morality "*which has been described as follows: The fact that the colonists were constantly evading the Navigation Acts, and made no pretense of paying the duties imposed by England must have had a demoralizing effect, and taught them to evade duties imposed by their own lawmakers…..*"[224] Although this description does not take into account that one of the main reasons that the colonists chose to resist the various tax acts was because they did not want the Crown to tax them without having fair representation in Parliament, it does show the early beginnings of Americans choosing to evade taxes whether the reasons behind the choice were considered legitimate grievances or not.

Today, the United States is one of the only countries that taxes based on citizenship, not residency, but taxation has not always been citizenship-based. While the country was still in its infancy, it taxed its citizens based on residency and at one point relied

[221] Richard A. Gordon, Special Counsel for International Taxation, *Tax Havens and Their Use by United States Taxpayers – An Overview*, Department of the Treasury, Publication No. 1150 (4-81) (1981).
[222] Ira Stoll, *Samuel Adams: A Life*, 54, 77 (Free Press 2008).
[223] Ira Stoll, *Samuel Adams: A Life*, 66 (Free Press 2008).
[224] Richard A. Gordon, Special Counsel for International Taxation, *Tax Havens and Their Use by United States Taxpayers – An Overview*, Department of the Treasury, Publication No. 1150, 21 (4-81) (1981).

on tariffs as a source of revenue.[225] However, less than a hundred years later the very violent and bloody Civil War would challenge the existing tax structure. When Congress passed the first income tax to fund the Civil War[226], it taxed its citizens only on their U.S. income, not on income that was earned abroad.[227]

In 1864 (the Civil War would end the following year), the U.S. converted to a citizenship-based taxation structure so any income earned anywhere in the world would be taxed. Then, in 1894, Congress enacted a federal income tax which was quickly declared unconstitutional with the Supreme Court holding that the income tax was a direct tax that was not apportioned with each state's population.[228] The 16th Amendment, ratified in 1913, was in response to this Supreme Court decision[229] and gave Congress the power to tax income *from whatever source derived.*[230] This amendment allowed for the foundation of the modern U.S. tax system that is present today. The American system was no longer a residency-based taxation regime but was now based on citizenship which meant a U.S. citizen was taxed on his or her worldwide income. It mattered not where the income came from. All that mattered was that one was an U.S. citizen. The United States still, today, adheres to the notion that all worldwide income of U.S. citizens, whether a business or a private individual, results in U.S. tax liability simply for holding U.S. citizenship.[231]

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[225] Randolph E. Paul, *History of Taxation in the United States*, William & Mary Annual Tax Conference, 6 (1955).
[226] Randolph E. Paul, *History of Taxation in the United States*, William & Mary Annual Tax Conference, 6 (1955); *See also, History of the U.S. Income Tax, available at* https://www.loc.gov/rr/business/hottopic/irs_history.html
[227] *History of the U.S. Income Tax*, https://www.loc.gov/rr/business/hottopic/irs_history.html
[228] Joel S. Newman, *Federal Income Taxation: Cases, Problems and Materials*, 11 (West Publishing, 5th edition, 2012); *See also, History of the U.S. Income Tax*, https://www.loc.gov/rr/business/hottopic/irs_history.html; Randolph E. Paul, *History of Taxation in the United States*, William & Mary Annual Tax Conference, 6 (1955).
[229] Joel S. Newman, *Federal Income Taxation: Cases, Problems and Materials*, 11 (West Publishing, 5th edition, 2012); *See also*, Randolph E. Paul, *History of Taxation in the United States*, William & Mary Annual Tax Conference, 7 (1955).
[230] U.S. Const. amend. XVI (Author's emphasis).
[231] Robert T. Kudrle and Lorraine Eden, *The Campaign Against Tax Havens: Will It Last? Will It Work?* 9 Stan. J. L. Bus. & Fin. 37 (Autumn 2003).

The citizenship-based residency now presented the problem of double-taxation – one fundamental problem of international taxation[232] – on American citizens by both their home country and the country of their residence. Americans sought relief from double taxation and in 1918, the U.S. responded by passing the Foreign Tax Credit which allowed American citizens to take a credit against U.S. income for taxes paid to a foreign government on income earned outside the United States in order to alleviate the burden.[233] Thomas S. Adams, who is considered the founder of the modern U.S. international tax system, argued in favor of the tax credit stating "*there is something in the legislative mind which recognizes that if one taxpayer is being taxed twice while the majority of men similarly situated are being taxed only once, by the same tax something wrong or inequitable is being done…*"[234] Adams recognized that tax evasion would become a problem if relief was not granted to the taxpayer and that a credit for foreign taxes paid would hopefully "*prevent abuse of that privilege*"[235].

Already by the early 1920s tax evasion was a concern not just to Adams but to Congress as well. In 1921, Congress, at the urging of Adams, passed a limitation on the Foreign Tax Credit (and source rules) in order to prevent abuse of the credit, for example, where a taxpayer who lived in a high tax country would utilize the credit in order to eliminate the entire tax owed to the United States. The concern was that the Foreign Tax Credit had created an atmosphere that allowed the taxpayer to potentially abuse the system.[236] Adams considered tax evasion to be of grave concern and that not limiting the Foreign Tax Credit would allow significant abuse.[237]

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[232] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 Duke Law J. 1027 (1997).
[233] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 Duke Law J. 1022 (1997).
[234] Thomas S. Adams, *International and Interstate Aspects of Double Taxation,* Proceedings of the Annual Conference on Taxation under the Auspices of the National Tax Association, 22 Nat'l Tax Assoc. 197 (1929).
[235] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 Duke Law J. 1039 (1997).
[236] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 Duke Law J. 1055 (1997).
[237] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation,* 46 Duke Law J. 1055 (1997).

Even in the early part of the 20th century, there was concern about various tax avoidance strategies with regard to business income and corporations including schemes such as incorporating in foreign jurisdictions with low taxes and attempts by corporations to manipulate prices between themselves and their subsidiaries in order to reduce their overall tax liability.[238]

While the legislative branch had passed the citizenship-based transaction, the Supreme Court addressed the issue in a 1924 case, *Cook v. Tait.* This case questioned whether or not it was constitutional to impose tax on income from property located outside the territorial U.S. and owned by a U.S. citizen that resided permanently outside the U.S.[239] The Court held that "….*the basis of the power to tax was not and cannot be made dependent upon the situs of the property in all cases, it being in or out of the United States, nor was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as a citizen to the United States and the relation of the latter to him as a citizen. The consequences of the relations is that the native citizen who is taxed may have domicile and the property from which his income is derived may have situs, in a foreign country and the tax be legal – the government having the power to impose the tax*."[240]

In between 1913 and 1937, there were thirteen Revenue Acts that were passed and with each Act there was an effort made to close the loopholes that allowed tax evasion, but as one scholar noted in 1937, the *"legislative efforts appear to be still nebulous because evidently there are still loopholes to be plugged*."[241] Since 1940, eighty-one pieces of tax legislation have been enacted and the years 1980-1989 (22) and 2000-2009 (20) were the decades that saw the most legislation passed[242] and yet today tax evasion remains a problem.

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[238] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 Duke Law J. 1060 (1997).
[239] *Cook v. Tait*, 265 U.S. 47 (1924).
[240] *Cook v. Tait*, 265 U.S. 48 (1924).
[241] William Cogger, *Tax Avoidance versus Tax Evasion*, 15 Tax Mag. 518, 519 (1937).
[242] Tax Policy Center, *Laws & Proposals*, https://www.taxpolicycenter.org/laws-proposals

Today the federal tax system that was initially set up beginning in the civil war era continues today - albeit more complicated, cumbersome and facing some of the same issues it has since the beginning. The rest of the thesis will discuss what anti-tax evasion measures the IRS has at its disposal to obtain taxpayer information on their foreign financial accounts in order to correctly and fairly administer the tax laws.

CHAPTER 3. U.S. EFFORTS TO DEFINE OR BLACKLIST TAX HAVEN JURISDICTIONS

3.1. GENERALLY

At first glance this chapter may seem out of context in light of the issue at the center of this thesis – that the Internal Revenue Service (hereinafter referred to as IRS) is not able to procure taxpayer information on foreign accounts to administer the tax laws fairly and correctly – yet it is not.

Why is this chapter applicable to this thesis? The answer is fairly simple – the anti-tax evasion measures such as those discussed in this dissertation have been developed and enacted in response to jurisdictions that use secrecy to conceal taxpayers' assets. The background behind the answer is not quite as simple and distracts away from the true impediment to procuring taxpayer information on foreign accounts – secrecy. In order to discuss the anti-tax evasion measures and why it is difficult for the IRS to obtain taxpayer information on foreign accounts, it is important to understand that the method of blacklisting and definition drafting, while potentially effective for other controversies related to jurisdictions that are alleged to be tax havens, are not effective when addressing the issue of secrecy.

For many years, the response that governments and organizations had – including national, supranational and non-governmental organizations (hereinafter referred to as NGOs) – to the problem that secrecy presented was attempting to control those jurisdictions that were alleged to be tax havens by both identifying characteristics of tax havens and/or shaming the "*bad apples*" by placing them on a blacklist instead of addressing secrecy which prohibited them from procuring taxpayer information. This is a two-prong attack. The first prong is to attack the tax havens from a political

standpoint – deciding what a tax haven is and what jurisdiction to attack. In other words, naming and shaming a jurisdiction into cooperating. The second prong is relying on the international legal remedies. The blacklist and definitional approaches go after the jurisdiction specifically, but the measures in this thesis go after the taxpayer that is utilizing the secrecy to conceal accounts either directly or indirectly (via third parties). These approaches failed for multiple reasons including (but not limited to) lack of political will (at least within the U.S. and as seen via the multiple failures of bills that included definitions or blacklists), inconsistent or lack of methodology in drafting the lists or criteria, or the inability to back up the blacklist with sanctions or "*hard power*" as Katrin Eggenberger calls it.[243] Tax havens are a disease that cannot be cured. Instead, the symptoms are treated of which secrecy is the greatest of the symptoms because it is not just the rich concealing money but also drug, weapons and human traffickers that use the secrecy to conceal their profits and activities.

The U.S. can be included in the list of governments and NGOs such as Venezuela, the UK and the EU that have tried to pursue a definition that would nail down the specific characteristics of tax havens and/or trying to adopt blacklists of jurisdictions. They adopted this method in the hopes that this would keep taxpayers from utilizing these jurisdictions, but despite these attempts, non-compliance with U.S. tax laws continues to be a problem. This can partly be attributed to that some of the focus of the politicians was mostly on the jurisdiction itself and not the secrecy the jurisdiction offers.

First, the chapter will delve into the blacklists and definitions that have been presented in the past (including the very recent past) in order to address the problems that tax

[243] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, presented at the "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/Deconstructing NationalBlacklists.pdf; *See also,* Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).

havens have presented to the various governments and their taxing authorities. Next, the chapter will discuss the U.S.' attempts at defining and blacklisting within a couple of the U.S. federal agencies. The same section will consider a few pieces of legislation that Congress tried to enact that included either a blacklist, definition or both. Finally, the chapter will examine the real issue that is at the heart of it all: secrecy. This section of the chapter will discuss, briefly, thoughts on why the blacklisting and definitions have not worked and what, if anything, the U.S. can do if it wants to incorporate a blacklist or definition within legislation.

3.2. BACKGROUND ON ATTEMPTS AT SOLVING THE TAX HAVEN PROBLEM

3.2.1. GENERALLY

There are usually two approaches to identifying tax havens. The first is by employing a blacklist of jurisdictions. The second approach is by drafting a definition using substantive criteria, for example, no or low tax. The next few pages will describe, in broad terms, tax haven definitions and then blacklists to demonstrate that this has been one approach employed to deter tax evasion and to try to procure information on taxpayers' accounts.

3.2.1.1 Defining Tax Havens

There is generally no universal definition as to what qualifies as a tax haven.[244] This conclusion can be seen across the academic literature through the research of the scholars, nevertheless, many scholars (as well as governments) have sought to define what qualifies as a tax haven despite the problematic nature of trying to pin down a subject that is complicated, diverse and ever-changing.[245]

Most definitions of tax havens fall into one of two categories: classical or non-classical definitions. Most scholarly articles endorse the classical definition of tax havens (low tax, bank secrecy, etc.) or some form of it, while a minority of scholars advocate for non-classical tax haven criteria.

In discussing what can be referred to as the classical definition, Janelle Gravelle has suggested the restrictive definition versus a broad definition of tax havens.[246] The restrictive criteria definitions contain additional criteria such as lack of transparency, bank secrecy and lack of economic activity that reaches beyond just the low-tax criteria of the broad definitions.[247] An example of more restrictive criteria is the characteristics presented by the OECD in 1998.[248] This list of four key characteristics,

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[244] Nicholas Shaxson, *How to Crack Down on Tax Havens*, Foreign Affairs, Feb. 13, 2018; *See also*, Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 Oxford Rev. Econ. Pol'y 661 (Oct. 2008); Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 402 (Autumn 2013); Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U.L. Rev. 337, 343 (January 2014); Tulio Rosembuj, *Harmful Tax Competition*, 27 Intertax 316, 328 (1999); Tyler J. Winkleman, *Automatic Information Exchange as a Multilateral Solution to Tax Havens*, 22 Ind. Int'l & Comp. L. Rev. 193,197 (2012); Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 Ind. J. Global & Legal Stud. 703, 705-706 (Summer 2009); Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8 (Penguin Random House, 2016); Myla Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32 Intertax 95 (2004).

[245] Myla Orlov, The Concept of Tax Haven: A Legal Analysis, 32 Intertax 102 (2004).

[246] Janelle Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, 62 Nat'l Tax Assoc. 727, 728 (December 2009); *See also*, *Commission Staff Working Document Impact Assessment*, at 117, COM (2012) SWD 404 final (2012) citing Janelle Gravelle's article.

[247] Janelle Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, 62 Nat'l Tax Assoc. 727, 728 (December 2009).

[248] OECD, *Tax Havens: Summary of the Findings of the First Study of International Tax Avoidance and Evasion: Four Related Studies*, 15 Intertax 122 (Paris 1987).

is referred to by or is the basis of many scholars' definitions[249] for what qualifies as a tax haven. The four characteristics that the OECD listed were:

a) No or only nominal taxes and offers itself, or is perceived to offer itself, as a place used by non-residents to escape tax in their country of residence;
b) Laws or administrative practices which prevent the effective exchange of relevant information with other governments on taxpayers benefitting from the low or no tax jurisdiction;
c) Lack of transparency; and
d) The absence of a requirement that the activity be substantial.[250]

As a 2012 EU working document notes, when the broad definition of tax havens is used the list of jurisdictions becomes excessive in length.[251] Both the Tax Justice Network and author/journalist Nicholas Shaxson - as well as a number of academic scholars[252] - have utilized the broad definition that declares that a "*tax haven provides facilities that enable people or entities to escape the laws, rules and regulations of*

[249]For examples, George Pagano, *The United States Went to War to Avoid the Red Coats' Taxes – Now Corporations are Sprinting to the United Kingdom's Tax Rate*, 39 Suffolk Transnat'l L. Rev. 427,430 (Summer 2016); See also, Tulio Rosembuj, *Harmful Tax Competition*, 27 Intertax 316, 329 (1999); Tyler J. Winkleman, *Automatic Information Exchange as a Multilateral Solution to Tax Havens*, 22 Ind. Int'l & Comp. L. Rev. 193,197 (2012); Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 Ind. J. Global & Legal Stud. 703, 705-706 (Summer 2009).

[250] OECD, *Tax Havens: Summary of the Findings of the First Study of International Tax Avoidance and Evasion: Four Related Studies*, 15 Intertax 122 (Paris 1987); See also, Organization for Economic Co-operation and Development (OECD), *Harmful Tax Competition: An Emerging Global Issue*, at 22, OECD Report (1998).

[251] Commission Staff Working Document Impact Assessment, at 117, COM (2012) SWD 404 final (2012) citing Janelle Gravelle's article; See also as examples of broad definitions, Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U.L. Rev. 337, 343 (January 2014); Mykola Orlov, *The Concept of Tax Haven: A Legal Analysis*, 32 Intertax 95, 97 (2004).

[252] Jeffery Kraft, *Changing Tides: Tax Haven Reform and the Changing Views of Transnational Capital Flow Regulation and the Role of States in a Globalized World*, 21 Indiana J. Global Legal Stud. 599, 600 (Summer 2014); See also, Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 Ind. J. Global & Legal Stud. 703, 705-706 (Summer 2009).

other jurisdictions elsewhere, using secrecy as a prime tool."[253] Nicholas Shaxson also uses a broad definition of tax havens in his book *Treasure Islands: Tax Havens and The Men Who Stole the World*[254] defining tax havens as "*a place that seeks to attract business by offering politically stable facilities to help people or entities get around the rules, laws and regulations of jurisdictions elsewhere*." The EU has described a broad definition of tax havens as jurisdictions that "*provide taxpayers, both legal and natural persons, with opportunities for tax avoidance, while their secrecy and opacity also serves to hide the origin of the proceeds of illegal and criminal activities*."[255]

In the non-classical category of tax haven definitions, there is a minority of scholars that identify other criteria other than what has been listed within the classical definition. For example, Dharmapala and Hines[256] while noting that tax havens generally are jurisdictions that have low or zero taxation and bank secrecy laws, they also favor characteristics that are atypical of the classic definition. They argue that tax havens are island countries with small populations, they are in close proximity to major capital exporters, affluent and have a sophisticated communications infrastructure. They also argue that tax havens are "*poorly endowed with natural resources*"[257] while others draw attention to the connection many tax havens have with the United Kingdom as former and current territories or jurisdictions that have

[253] https://www.taxjustice.net/fag/tax-havens/ ; *See also*, Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8 (Penguin Random House, 2016).
[254] Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8-9 (Penguin Random House, 2016).
[255] Cecile Remeur, *Listing of Tax Havens By the EU*, European Parliamentary Research Service (May 2018), *found at* http://www.europarl.europa.eu/cmsdata/147404/7%20-%2001%20EPRS-Briefing-621872-Listing-tax-havens-by-the-EU-FINAL.PDF
[256] Dharmapala, D. and J. R. Hines, Jr. (2006) "*Which Countries Become Tax Havens*?" NBER Working Paper #12802; *See also*, Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 Oxford Rev. Econ. Pol'y 661, 664 (Oct. 2008); James R. Hines Jr., *Do Tax Havens Flourish?*, 19 Tax Pol'y & Econ. 65, 77 (2005); Clemens Fuest, *Tax Havens: Shady Deals*, 67 The World Today 16 (July 2011).
[257] Dharmapala, D. and J. R. Hines, Jr. (2006) "*Which Countries Become Tax Havens*?" NBER Working Paper #12802.

strong ties to the UK.[258] The minority definition, while more narrow, is a more inconsistent definition. Examining the various lists of countries considered tax havens, multiple countries do not fit within the non-classical definitions. For example, Switzerland, Panama and Belgium, among others, do not fit within the small country characteristic.[259] The affluence characteristic is defied by alleged tax haven countries such as Vanuatu, Nauru and Samoa.[260] This demonstrates that a broader tax haven definition, if utilized, allows for more accuracy when trying to define what jurisdictions qualify as tax havens especially if the definition looks to what the laws of the jurisdiction contains (i.e., secrecy, effective exchange of communication) instead of more descriptive characteristics such as size. The difference in broad versus narrow or majority versus minority definitions, also establishes the difficulty with trying to pin down what a tax haven is.

The variety of definitions that are presented in the academic literature used to define tax havens – when viewed in light of the amount of academic research done on the topic of tax havens – demonstrates that trying to define a phenomenon that causes the very experts writing on these issues to struggle suggests that the true issue needs to be acknowledged and addressed. That issue is that it is not the jurisdictions themselves that the taxpayers' go for, but the wall of secrecy that the jurisdictions' rules and regulations provide. Another way to put it is that people do not seek out Vanuatu to hide their money because it is Vanuatu, instead they seek out the secrecy that Vanuatu's rules and regulations provide.

The next section will discuss briefly the attempts to use blacklists to achieve the same goals in the same manner as with the definitions.

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[258] Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 402 (Autumn 2013); See also, Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8-9 (Penguin Random House, 2016).
[259] CIA, *The World Factbook: Country Comparison GDP – Per Capita*, *found at* https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html
[260] Asian Development Bank, *Poverty in the Cook Islands*, *found at* https://www.adb.org/countries/cook-islands/poverty

3.2.1.2 Blacklists

A blacklist is a policy tool that is used for multiple reasons. Generally, a blacklist is a public roster of entities – or more specifically, for this thesis, jurisdictions – that are viewed in an adverse light. The blacklist is used to support policy objectives with the aim of changing the listed jurisdictions' behavior.[261] Blacklists present two potential consequences for suspected jurisdiction: reputational or financial costs.[262]

The blacklist came into the international relations terminology during the First World War when the British enacted the Trading with Enemy Act of 1915 which listed companies that were aiding their enemies and prohibited their citizens from trading with these companies.[263] Blacklisting has since become an avenue that governments and others are comfortable using as a policy tool. There fact that there are 400+ lists used worldwide proves that this is a popular path taken to deal with various aspects of tax havens.[264] The general definition of a blacklist noted above is a broader definition that includes money laundering and non-proliferation as well as secrecy jurisdictions or tax havens.[265] This section of the thesis is only concerned with blacklists that focus on the secrecy/aspects of tax havens and will, therefore, focus on those types of lists.

Multiple countries, international organizations and the EU, a supranational governmental organization, have created blacklists that contain jurisdictions they

[261] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[262] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483 (2018).
[263] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 485 (2018).
[264] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 485 (2018).
[265] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483 (2018).

identify as tax havens. These jurisdictions or entities employ a tax haven blacklist so that they can try to "*limit tax losses at home by limiting or barring transactions carried out by their citizens or corporations with certain specified foreign jurisdictions*."[266]

The next natural question to ask is what, specifically, is a tax haven blacklist? A national tax haven blacklist is legislation or regulations that prescribe negative treatment such as reputational or financial consequences for certain specific listed foreign jurisdictions.[267] This is differentiated from the lists of objective criteria, but the tax haven blacklists may be based on those lists of objective criteria. This distinction is important because, according to Sharman and Rawlings, the blacklists conflict with "*widely-held principles at the heart of the international trade system*" – for instance, discriminating on national grounds.[268]

Can a blacklist be an effective tool against tax havens? The opinions are wide and varied.[269] In her article, Katrin Eggenberger examines when blacklisting is effective and found that when a blacklist is viewed as legitimate, has a stigma attached to the act committed (tax evasion versus money laundering) and the sanctions are of a "*hard power*" nature, a blacklist can be very effective.[270] For example, she compares the OECD blacklist and the Financial Action Task Force (FATF) blacklist. The article

[266] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at the "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/Deconstructing NationalBlacklists.pdf
[267] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at the "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/Deconstructing NationalBlacklists.pdf; *See also*, Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[268] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at the "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/Deconstructing NationalBlacklists.pdf
[269] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 486 (2018) (quoting multiple authors challenging the legitimacy of blacklisting).
[270] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).

concluded that the FATF's blacklist was much more effective because money laundering is seen (or has been seen) as a bigger violation than tax evasion (stigma) and that the FATF followed through and imposed sanctions.[271] The OECD's list was merely seen as a threat because it had no follow through to it and was viewed as a non-legitimate list by the identified jurisdictions.[272] Eggenberger noted that it took five years for the FATF countries to come into compliance in conflict with the nine years for the countries reported on the OECD blacklist to comply.[273]

While blacklists can exert hard power through sanctions as noted by Eggenberger, it can also destroy countries.[274] Take the country Nauru, for example, which is a tiny Pacific island with a population of 11,000.[275] Nauru's only natural resource, phosphate, was depleted.[276] As a result, Nauru then became known for selling "*economic citizenship through passports as well as offshore banking licenses with secrecy provisions*."[277] Following a money laundering scandal that revealed the Russian Federation was laundering money through Nauru, the jurisdiction was added to both the OECD and the FATF blacklists.[278] The FATF eventually sanctioned Nauru

[271] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[272] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[273] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 484 (2018).
[274] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 485 (2018).
[275] Government of Nauru, *About Nauru: Our Country*, found at http://www.naurugov.nr/about-nauru/our-country.aspx
[276] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 495 (2018); See also, Government of Nauru, *About Nauru: Our Country*, found at http://www.naurugov.nr/about-nauru/our-country.aspx
[277] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 495 (2018".
[278] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 495 (2018).

who, at the same time, was also being sanctioned under the U.S. Patriot Act. Nauru acquiesced and committed to the OECD standards and the jurisdiction was eventually removed from both the OECD and FATF blacklists.[279] Unfortunately, the reputational and financial costs were disastrous as they had undermined Nauru's already fragile and vulnerable economy.[280] As Eggenberger noted, Nauru is impoverished as a result of both the decline of their natural resource – production of phosphate – and the decline of the offshore banking business.[281] "*Many functions of the state have collapsed, it depends on foreign aid, has turned to maintaining detention camps for Australian immigrants for revenue, and has most of the characteristics of a failed state*."[282]

Nauru is undoubtedly seen as a blacklist success story for those that are trying to put an end to money laundering and tax evasion, but is it appropriate that the result is a country that is forced into an impoverished state? This is one of the many criticisms that blacklists face and it is a compelling and accurate criticism.

As noted above, the criticism against blacklists is wide and varied. Among the reasons listed is whether a blacklist is legitimate, that it affects political and human rights and that blacklisting has been challenged as "*politically charged, biased and open to lobbying*."[283]

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[279] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 496 (2018).
[280] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 496 (2018).
[281] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[282] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).
[283] Katrin Eggenberger, *When is Blacklisting Effective? Stigma, Sanctions and Legitimacy: The Reputational and Financial Costs of Being Blacklisted*, 25 Rev. Int'l Pol. Econ. 483, 497 (2018).

Another considerable criticism is that blacklists are arbitrary and discriminatory. This can be observed in how blacklists are constructed.[284] What are the procedures for drafting a blacklist? Are there any? Are they transparent? These are all questions to consider when examining whether blacklists are arbitrary and discriminatory. According to Sharman and Rawlings, the answer to those questions is there are generally no procedures and when there are the procedures are not transparent.[285] They argue that there is no consistently applied method in identifying jurisdictions that belong on the blacklist.[286] This is evidenced by tax haven lists that can vary widely with the countries that are placed on those lists. For example, the Netherlands and Ireland are on some tax haven blacklists[287] yet other lists such as the current EU blacklist do not contain either country. This varying nature of tax haven lists lends itself to well-earned criticism[288]. One perspective suggests it is a bit of a David versus Goliath battle where the tax haven countries – viewed as the small guy – won out.[289] This is because the OECD blacklist was never viewed as effective in contradiction to the FATF's list as discussed above. But one wonders if Nauru feels that the little guy won out.

Another issue to contemplate when drafting a blacklist, and a problem that exists across established blacklists, is not just the inconsistencies that appear - such as

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[284] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/DeconstructingNationalBlacklists.pdf

[285] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/DeconstructingNationalBlacklists.pdf

[286] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/DeconstructingNationalBlacklists.pdf

[287] Janelle Gravelle, Tax Havens: I*nternational Tax Avoidance and Tax Evasion*, 62 Nat'l Tax Assoc. 727, 731 (December 2009) (citing Altshuler and Grubert (2006) and van Dijk, Wyzig and Murphy (2007).

[288] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, Presented at "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/DeconstructingNationalBlacklists.pdf; J.C. Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation*, (Cornell University Press, 2006)

[289] J.C. Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation*, 85 (Cornell University Press, 2006)

Venezuela including St. Christopher onto their blacklist but delisting St. Kitts despite being the exact same geographical entity (same island) - but also having no methodology for not only compiling the lists but updating them by listing or delisting countries.[290]

The blacklists present, essentially, a circular issue: to have a blacklist one needs to have a substantive list of characteristics or elements to identify them with. If there is no qualifying characteristic, then it becomes an arbitrary selection with no valid reason for those jurisdictions to be included. In order to have criteria to identify jurisdictions one must have an idea of the jurisdictions they are targeting – for example, Bermuda, in order to develop the criteria.

Based on the above discussion, it seems, that to have a solid, effective blacklist, there should be a consistent methodology that includes objective criteria that identifies and places jurisdictions on a list that will be viewed as legitimate. This method should also include an annual or biannual review of the list to update the jurisdictions. The method should also include hard sanctions and a stigma that those jurisdictions want to avoid. The sanctions and stigma should not be so severe though that it forces a country into an impoverished state that it cannot recover from.

3.3. U.S. DEFINITION AND BLACKLIST ATTEMPTS

3.3.1. PRIOR U.S. ATTEMPTS AT ADDRESSING TAX HAVENS

In one of the first, and definitely the most definitive, attempts at defining what a tax haven is by the U.S. government came in the form of a report written in 1981 by Richard A. Gordon who, at the time, was Special Counsel for the International

[290] Jason Sharman and Gregory Rawlings, *Deconstructing National Tax Blacklists*, presented at "Beyond the Level Playing Field? Symposium (September 19, 2009), *found at* https://www.step.org/sites/default/files/Comms/DeconstructingNationalBlacklists.pdf

Taxation Division of the Internal Revenue Service (IRS).[291] The Report (from hereinafter referred to as the "Gordon Report") was requested due to concerns at the time of the increasing use of tax havens by U.S. taxpayers to both avoid and evade tax liability. It suggested seven principal characteristics of tax havens: 1) low tax, 2) secrecy, 3) relative importance of banking, 4) availability of modern communications, 5) lack of currency controls, 6) self-promotion and tax aggression and 7) special situations. The Gordon Report, although not authoritative, is important because it has been the basis of many other definitions given by academic scholars, governments and organizations like the OECD, (for example, see the OECD criteria given in the above section 3.2.1.1). Although these definitions vary, most of them contain the first two criteria: low tax and secrecy. These two characteristics can be found in almost all the definitions and thus, can be considered the common core characteristics which will be discussed in more detail below. Not surprisingly, the Gordon Report did not call on the government to adopt the definition laid out in the report, but instead it "*called for a coordinated federal attack on the use of tax havens, including better coordination and funding of administrative efforts and substantive changes in U.S. law and U.S. tax treaty policy which included anti-tax evasion measures"*.[292] This has been the strategy of the U.S. government for almost a century and should continue to be the federal government's blueprint for how they procure taxpayer information on foreign accounts because this is an effective strategy when dealing with secrecy and its multifaceted nature.

In 1984, the Secretary of the Treasury submitted an update to the Gordon Report called Tax Havens in The Caribbean Basin and it was linked to legislation titled

[291] Richard A. Gordon, Special Counsel for International Taxation, *Tax Havens and Their Use by United States Taxpayers – An Overview*, Department of the Treasury, Publication No. 1150 (4-81)(1981).
[292] United States General Accounting Office, Statement of William J. Anderson, Director, before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives on Federal Efforts to Define and Combat the Tax Haven Problem (April 1983).

Caribbean Basin Economic Recovery Act.[293] The purpose behind the report was to present to the House and the Senate three items of information. First, the level at which the Caribbean Basin tax havens were being used at the time to evade U.S. tax and the effect that it had on Federal tax revenues.[294] The second requirement was to provide information on the relationship between the tax use and non-tax use (i.e., criminal use, drug trafficking).[295] Last, the report was to describe any anti-tax haven enforcement measures taken by the Treasury Department.[296] According to the report, the request reflected the "*strong and growing concern shared by the Administration and Congress that tax havens may provide opportunities for…..the avoidance and evasion of U.S. taxes*."[297] However, the scope of the report was limited only to the tax havens found in the area of the Caribbean and not the tax havens in other geographic locations.

The Caribbean Report cited the characteristics of tax havens that were fleshed out in the Gordon Report. It also cited the four ranges of use for tax havens that Gordon argued for. The purpose of the Caribbean Basin Initiative was to provide tax benefits to those suspected tax haven jurisdictions in the Caribbean in lieu of their piercing their veil of secrecy in order to provide information to the U.S. authorities to help with the enforcement of U.S. laws.[298]

U.S. officials during the 1980s seemed to be resolute in their determination to identify tax havens by name publicly. Today, U.S. officials convey the impression that they

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[293] United States Department of the Treasury, *Tax Havens in the Caribbean Basin,* Pub. No. O-430-492 (U.S. Government Printing Office, 1984); *See also, In the Matter of Tax Liabilities of John Does,* 2002 WL 32153784 (N.D. Cal. 2002); Declaration of Barbara Kallenberg, *In the Matter of Tax Liabilities of John Does,* No. 5:05-cv-04167-PVT (N.D. Cal. 2005).

[294] United States Department of the Treasury, *Tax Havens in the Caribbean Basin,* Pub. No. O-430-492 (U.S. Government Printing Office, 1984).

[295] United States Department of the Treasury, *Tax Havens in the Caribbean Basin,* Pub. No. O-430-492 (U.S. Government Printing Office, 1984).

[296] United States Department of the Treasury, *Tax Havens in the Caribbean Basin,* Pub. No. O-430-492 (U.S. Government Printing Office, 1984).

[297] United States Department of the Treasury, *Tax Havens in the Caribbean Basin,* Pub. No. O-430-492 (U.S. Government Printing Office, 1984).

[298] Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Crime and Secrecy: The Use of Offshore Banks and Companies*, 42 (U.S. Government Printing Office, 1983).

are a lot more reluctant to identify specific jurisdictions either through a definition or through a blacklist. The lack of enacted legislation that identifies tax havens (see subsection 3.3.2) is evidence of this. In one hearing in the early 1980s, an Assistant Secretary of the Treasury, when asked how he would rate the haven jurisdictions on the secrecy characteristic, did not hesitate when he identified Panama, the Cayman Islands, the Netherland Antilles and the Bahamas as those jurisdictions which had secrecy laws that were the hardest to penetrate.[299] However, that willingness to identify tax havens seems to have reversed itself. In a Government Accounting Office's (GAO) report in 2013, one Assistant Secretary warned of the use of identifying specific jurisdictions by using a blacklist or by criteria as there was no agreed upon definition or blacklist.[300]

Another example of the willingness to identify tax havens by name in the 1980s comes in the form of a handbook that was created so that IRS agents could use it as a resource when encountering a tax haven problem.[301] The Tax Haven Information Book has a list of 28 jurisdictions identified as tax havens with detailed information on each identified jurisdiction. The book had at least two editions, one in 1982 and one in 1984. These books were difficult to find copies of. The 1982 version can be found online, however, the author was not able to locate a copy of the 1984 edition. The purpose of these books was to provide the IRS agents working on tax haven issues in the 1980s with information on individual jurisdictions considered to be tax havens. These books, while informative, are only persuasive in nature and were meant as a resource guide and not, as noted at the front of the 1982 version, as a book that would be cited as authority.

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[299] U.S. Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Crime and Secrecy: The Use of Offshore Banks and Companies*, 42 (U.S. Government Printing Office, 1983).

[300] GAO, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars but May Be Missing Continued Evasion*, GAO-13-318 (March 2013).

[301] IRS, *Tax Haven Information Book*, Doc. 6743 2-82 (U.S. Gov't Printing Office, 1982), *found at* https://catalog.hathitrust.org/Record/101663072; *See also*, IRS, *Tax Haven Information Book*, Doc. 6743 (4-84) (U.S. Gov't Printing Office, 1984).

The 1983 House of Representatives hearing titled Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries also points to the willingness to overtly identify tax havens by name through the singling out of the Netherland Antilles in the title of the hearing while noting that, of course, there are other tax haven countries.[302] The purpose of this hearing was to obtain information on the nature and severity of the use of the Netherlands Antilles for tax evasion purposes and to examine whether or not the federal government's response to the use of tax havens (including the Netherlands Antilles) by U.S. taxpayers to evade taxes was adequate or not.

The Gordon Report and the subsequent examples are by no means the only example of attempts by the various agencies and departments in the U.S. federal government to define, unofficially, what a tax haven jurisdiction is. Some of these attempts to formulate definitions or blacklists sometimes reference other definitions such as the OECD's. The next few sections will discuss the various definitions or blacklists found among the legal or government sources.

It's obvious that the U.S. government was concerned in the 1980's by the use of tax haven jurisdictions by U.S. taxpayers and were very willing to identify by name the jurisdictions they thought presented the biggest threats. But even then, the U.S. government was focused on the jurisdictions themselves instead of really being focused on what drew the taxpayers to those jurisdictions.

3.3.2. PAST LEGISLATION ATTEMPTS

Blacklists and tax haven definitions have also made their way into legislation that was introduced to Congress. None of those definitions or blacklists, however, have ever made it into enacted tax law. There have been multiple pieces of legislation that have included blacklists and definitions, but there are too many to account for here in this

[302] U.S. Subcommittee of the Committee on Government Operations, House of Representatives, *Hearings: Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries*, 1-2 (U.S. Government Printing Office, April 1983).

thesis. Therefore, only a few will be used to demonstrate two things: 1) a few legislators have been interested in passing a blacklist and/or definitions into law to address tax evasion and 2) it does not seem to be the prevailing sentiment among the majority of politicians. This section will also examine what those lists and definitions looked like.

The earliest demonstration of tax legislation that contained a definition or blacklist came in the 107th (2001-2003) and 108th (2003-2005) congressional sessions. In the 107th Congress, Senator John Kerry introduced a bill called Tax Haven and Abusive Tax Shelter Reform Act.[303] The catalyst for this piece of legislation was the downfall of Enron, an American energy trader and supplier. Enron's undoing was identified as an example of corporations and individuals using tax havens to evade taxes.[304] Enron, itself, had 800 subsidiaries in tax havens and 692 of them in the Cayman Islands alone.[305] Kerry noted that this happened because it was "*cloaked in a web of bank secrecy and taxpayer privacy*."[306] The purpose of this bill was to curb tax abuses by disallowing tax benefits arising under transactions that did not have economic substance and to curb tax abuse that involved tax havens.[307] The bill would have enacted multiple provisions to curb this tax abuse such as limiting the Foreign Tax Credit and deferral, requiring strict U.S. taxpayer outbound transfers reporting and requiring disclosure requirements on tax shelter participants as well as the reporting of interest in a foreign financial account.[308] It would also have imposed penalties for those that participate in or promote abusive tax shelters in addition to an increase in a civil penalty from 20% to 40% when a taxpayer fails to report an interest in an offshore account.[309] S. 2339 was drafted to discourage the use of identified tax havens but in

[303] 107th Congress, Tax Haven and Abusive Tax Shelter Reform Act, S. 2339 (April 26, 2002).
[304] 107 Cong. Rec. 3467-3471 (April 26, 2002).
[305] 107 Cong. Rec. 3467-3471 (April 26, 2002).
[306] 107 Cong. Rec. 3467-3471 (April 26, 2002).
[307] 107 Cong. Rec. 3467-3471 (April 26, 2002).
[308] 107th Congress, Tax Haven and Abusive Tax Shelter Reform Act, S. 2339 (April 26, 2002).
[309] 107th Congress, Tax Haven and Abusive Tax Shelter Reform Act, S. 2339 (April 26, 2002).

order to accomplish this goal, the term tax havens needed to be qualified.[310] Under this bill, tax havens were defined through two criteria, low or no taxation and strict confidentiality rules or ineffective information exchange practices. These two criteria were to facilitate the formulation and maintenance of a list of foreign jurisdictions that would have been identified as tax havens.[311] The criterion on ineffective information exchange practices was explained further in the bill by identifying that this occurs when the "*Secretary determines that exchange of information between the United States and such jurisdiction is inadequate to prevent evasion or avoidance of the United States income tax by United States persons or to permit the effective enforcement of the taxes imposed by this title*."[312] S. 2339 died in committee.

In the 108th Congress, Senator Carl Levin, who had been the force behind most of the tax haven legislation from the early 2000s until his retirement, seemed to assume the mantle from John Kerry. He introduced S. 2210, the Tax Shelter and Tax Haven Reform Act, which focused on abusive tax shelters and uncooperative tax havens.[313] In order to define tax havens for the use in this legislation, the bill mirrored the definition found in John Kerry's earlier bill. According to Levin, the bill gave authority for a list that was to be drafted and maintained by the Secretary of the Treasury. This list was inclusive of foreign jurisdictions that were considered to be an "*uncooperative tax haven*" as defined by two criteria, low or no tax and corporate, business, bank or tax secrecy or confidentiality rules.[314] Two types of restrictions would have been applied to taxpayers doing business in the designated jurisdictions.[315] First, taxpayers would have had to provide greater disclosure on their activities within the designated jurisdictions on their tax returns.[316] The second restriction would have

[310] 107th Congress, Tax Haven and Abusive Tax Shelter Reform Act, S. 2339 (April 26, 2002).
[311] 107th Congress, Tax Haven and Abusive Tax Shelter Reform Act, S. 2339 (April 26, 2002).
[312] 107 Cong. Rec. 3467-3471 (April 26, 2002).
[313] 108th Congress, *Tax Shelter and Tax Haven Reform Act*, S. 2210 (March 12, 2004).
[314] 108th Congress, *Tax Shelter and Tax Haven Reform Act*, S. 2210 (March 12, 2004).
[315] 108th Congress, *Tax Shelter and Tax Haven Reform Act*, S. 2210, 2778-2781 (March 12, 2004) (Statement by Carl Levin).
[316] 108th Congress, *Tax Shelter and Tax Haven Reform Act*, S. 2210, 2778-2781 (March 12, 2004) (Statement by Carl Levin).

denied specific tax benefits such as the foreign tax credit for any income attributable to a jurisdiction designated as a tax haven.[317] The bill itself did not define what is considered to be "*low tax"* nor did Levin's statement on the bill. This bill also died in committee.

Senator Levin's bills were usually named Stop Tax Haven Abuse Act or something comparable.[318] For example, in the 111th Congress (2009-2010), Senator Levin introduced the Stop Tax Haven Abuse Act. The purpose was to restrict the use of offshore tax havens and abusive tax shelters which allowed taxpayers to inappropriately avoid federal taxation through various mechanisms such as denial of tax benefits for foreign corporations managed and controlled in the U.S. or the creation of two disclosure procedures that would have required third parties to report transactions undertaken by U.S. persons.[319] Senator Levin noted that the target of the bill is the "*offshore tax abuses that rob the U.S. Treasury of an estimated $100 billion each year, reward tax dodgers using offshore secrecy laws to hide money from Uncle Sam*…."[320] In the introductory remarks, he defines what a tax haven is focusing on the secrecy aspect of the tax haven jurisdiction and he notes that the target is the abuses, not necessarily the jurisdictions themselves. What allows the abuses? It is not because Bermuda is specifically Bermuda but, instead, because Bermuda's laws and regulations allow secrecy or allow financial organizations to operate without requiring the organizations to know the identities of the beneficial owners of the accounts. It is the secrecy that the taxpayers use to hide behind that allows the abuses to continue. In the actual bill presented to the Senate, the term "*offshore secrecy jurisdiction*" is

[317] 108th Congress, *Tax Shelter and Tax Haven Reform Act*, S. 2210, 2778-2781 (March 12, 2004) (Statement by Carl Levin).
[318] 112th Congress, *Stop Tax Haven Abuse Act*, S. 1346 (July 12, 2011); 113th Congress, *Stop Tax Haven Abuse Act*, S. 1533 (September 19, 2013)
[319] 111th Congress, *Stop the Tax Haven Abuse Act*, S. 506 (March 2, 2009); See also, Jeffery Kraft, *Changing Tides: Tax Haven Reform and the Changing Views of Transnational Capital Flow Regulation and the Role of States in a Globalized World*, 21 Indiana J. Global Legal Stud. 599, 600 (Summer 2014); James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 986 (2016-2017).
[320] 111th Cong. Rec., Vol. S.2624 (March 2, 2009); See also, James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 986 (2016-2017).

utilized denoting the importance of the secrecy despite the bill using "*tax havens*" in the title. According to Jeffery Kraft, the bill was to combat the veil of secrecy surrounding the tax haven jurisdictions via four rebuttable presumptions.[321] These four rebuttable presumptions addressed the control of an entity by a U.S. person, transfers of income, beneficial ownership and foreign financial accounts.[322]

S. 506 then provided an initial list of tax havens that included most of the familiar suspects, including, Antigua and Barbuda, Cayman Islands, Panama and Switzerland. This list was to be used in legal proceedings – civil or criminal – where tax needed to be determined or collected.[323] The initial list put forth by Senator Levin was compiled from Federal Court proceedings like the John Doe Summons (discussed in more detail in Chapter 6) where offshore jurisdictions had been publicly identified as secrecy jurisdictions by the IRS.[324] After the initial list had been compiled, the authority was given to the Secretary to list or delist foreign jurisdictions as offshore secrecy jurisdictions "*if the Secretary determines that such jurisdiction has* ***corporate, business, bank or tax secrecy rules and practices****, which in the judgment of the Secretary, unreasonably restrict the ability of the United States to obtain information relevant to the enforcement of this title, unless the Secretary also determines that such country has* ***effective information exchange practices***."[325] After being introduced in the Senate, the bill died in the Senate's Committee on Finance.[326] H.R. 1265, the companion House bill, which was also called Stop Tax Haven Abuse Act was referred to three different committees to decide which committee had jurisdiction but

[321] Jeffery Kraft, *Changing Tides: Tax Haven Reform and the Changing Views of Transnational Capital Flow Regulation and the Role of States in a Globalized World*, 21 Indiana J. Global Legal Stud. 599, 600 (Summer 2014).
[322]Jeffery Kraft, *Changing Tides: Tax Haven Reform and the Changing Views of Transnational Capital Flow Regulation and the Role of States in a Globalized World*, 21 Indiana J. Global Legal Stud. 599, 601 (Summer 2014).
[323] 111th Congress, *Stop the Tax Haven Abuse Act*, S. 506 (March 2, 2009).
[324] 111th Congress, *Stop the Tax Haven Abuse Act*, S. 506 (March 2, 2009).
[325] 111th Congress, *Stop the Tax Haven Abuse Act*, S. 506 (March 2, 2009).
[326] James F. Kelly, *International Tax Regulation by United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 987 (2016-2017).

ultimately the House bill suffered the same fate and never made it out of any of the three committees.[327]

In the same congressional session, the 111th, another bill was introduced under the name of Stop Outsourcing & Create American Jobs Acts of 2010.[328] This bill's purpose was to "*provide for the identification of corporate tax haven countries and increased penalties for tax evasion practices in haven countries that ship United States jobs overseas.*"[329] H.R. 5622 was sent to two committees where no further action was taken. This bill directed the Secretary of the Treasury to develop and publish a list of countries that were determined to be corporate tax havens. This bill can be distinguished from the two bills immediately above because this bill does not deliver a tax haven list but suggests that in developing such a list that the Secretary should consider certain criteria.[330] The criteria that the Secretary should have considered had the bill passed contained four of the classical criteria found in most tax haven definitions as noted in the sections above as well as two others: 1) tax rate in the country, 2) lack of effective exchange of information between governments, 3) lack of transparency in financial services sector, 4) lack of requirements of substantial economic activity, 5) incentives which may encourage a U.S. corporation to invest abroad rather than domestically and 6) other factors deemed necessary by the Secretary.[331] The Secretary would have been required to update the list every three years.[332] Despite the lack of success of these early bills, Carl Levin's attempts created the environment that was conducive for the introduction of the Foreign Account Tax

[327] 111th Cong., *Stop the Tax Haven Abuse Act*, H.R. 1265 (March 3, 2009); *See also*, https://www.congress.gov/bill/111th-congress/house-bill/1265/all-actions?q=%7B%22search%22%3A%5B%22H.R.+1265%22%5D%7D&r=1; James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 987 (2016-2017).
[328] 111th Cong., *Stop Outsourcing & Create American Jobs Act*, H.R. 5622 (June 29, 2010).
[329] 111th Cong., *Stop Outsourcing & Create American Jobs Act*, H.R. 5622 (June 29, 2010)
[330] 111th Cong., *Stop Outsourcing & Create American Jobs Act*, H.R. 5622 (June 29, 2010)
[331] 111th Cong., *Stop Outsourcing & Create American Jobs Act*, H.R. 5622 (June 29, 2010)
[332] 111th Cong., *Stop Outsourcing & Create American Jobs Act*, H.R. 5622 (June 29, 2010)

Compliance Act (FATCA) which is one of the measures that address the ongoing problem of accessing U.S. taxpayers' foreign accounts.[333]

In the most recent Congressional session (as of the writing of this thesis), the bills of virtually the same names were introduced. Two in the House and one in the Senate. H.R. 1712[334] and its Senate companion bill, S. 779, while both called Stop the Tax Haven Abuse Act, do not propose a blacklist of jurisdictions or a list of criteria any longer but, instead, attempt to strengthen various enacted bills such as the Foreign Account Tax Compliance Act (Chapter 9) or strengthening the IRS' anti-tax evasion measures such as John Doe Summons (Chapter 6) for the purpose of ending offshore corporate tax avoidance.[335] Both bills also address reporting on U.S. beneficial owners of foreign accounts (Qualified Intermediary Chapter 7 and FATCA). The third bill is S. 1609, referred to as the Disclosure of Tax Havens and Offshoring Act[336]. This bill's purpose was to amend the Securities Act of 1934 in order to require country-by-country reporting for multinational enterprise groups who have business in foreign jurisdictions.[337] This bill would have required the multinational enterprise group to disclose tax information about the group and the jurisdiction where they are resident.[338] S. 1609, despite the name, similarly does not contain a blacklist identifying the tax havens or criteria for a definition, but it does require that the group detail the financial information regarding their revenues and income as well as other information for tax purposes.[339] Unfortunately, there were no introductory remarks or any other type of information on these three bills other than the actual text of the bill. Once again, none of these three bills made it out of committee.

[333] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 987 (2016-2017).
[334] H.R. is short for House of Representatives so H.R. 1712 would be a bill that came out of the House.
[335] 116th Congress, *Stop Tax Haven Abuse Act*, S. 779 (March 13, 2019); 116th Congress, *Stop the Tax Haven Abuse Act*, H.R. 1712 (March 13, 2019).
[336] 116th Congress, *Disclosure of Tax Havens and Offshoring Act*, S. 1609 (May 22, 2019).
[337] 116th Congress, *Disclosure of Tax Havens and Offshoring Act*, S. 1609 (May 22, 2019).
[338] 116th Congress, *Disclosure of Tax Havens and Offshoring Act*, S. 1609 (May 22, 2019).
[339] 116th Congress, *Disclosure of Tax Havens and Offshoring Act*, S. 1609 (May 22, 2019).

The various and multiple attempts at trying to define what a tax haven jurisdiction is through a blacklist or substantive criteria via legislation never made it out of any committee.[340] While some pieces of introduced legislation had remarks explaining the purpose of the legislation and how it would have worked, there are no remarks or information regarding why these types of bills never made it out of committee. There could be multiple reasons for the failure, including lack of political will to identify tax havens specifically by name, or it could simply be that none of them passed out of committee because some of them do not address the actual issue – the inability to obtain information on U.S. taxpayers' foreign accounts due to secrecy rules which prohibit the IRS from applying the tax laws correctly and fairly.

3.3.3. INTERNAL REVENUE SERVICE

The IRS, the taxing authority, has no official list of criteria, however, on their website the agency defines a tax haven by only one characteristic: low or no tax.[341] The second core criterion, bank secrecy, is saved for the definition of "*offshore financial centers*".[342] The IRS distinguishes between an offshore financial jurisdiction and a tax haven, however, on another page on the website the information given contradicts the definitions given to these two terms. Instead, the IRS seems to say that the term offshore and tax haven are interchangeable. *"Such offshore transactions generally involve foreign jurisdictions that offer financial secrecy laws……These jurisdictions are commonly referred to as "tax havens" because, in addition to the financial secrecy they provide, they require little or no taxation of income from sources outside their jurisdiction.*"[343] This contradiction is indicative of the difficulty of defining what a

[340] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, (2013).
[341] IRS, *Glossary of Offshore Terms*, https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-glossary-of-offshore-terms
[342] IRS, *Glossary of Offshore Terms*, https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-glossary-of-offshore-terms
[343] IRS, *Abusive Offshore Tax Avoidance Schemes – Facts (Section I)*, https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-facts-section-i

tax haven is presents and, is possibly, one reason the U.S. has chosen to use anti-tax evasion measures to address secrecy rather than utilizing a blacklist or a definition approach.

As referenced earlier, the IRS, in the 1980s published at least two handbooks that were created so that IRS agents could use it as a resource when encountering a tax haven problem.[344] The Tax Haven Information Book[345] has a list of 28 jurisdictions identified as tax havens with detailed information on specific jurisdictions alleged to be tax havens – it was meant only as a guide. The book had at least two editions, one in 1982 and one in 1984. However, as far as the research can confirm, those handbooks are no longer in use.

The Internal Revenue Manual (IRM) at one time also had a list of tax havens according to Gary Tobin and Keith Walsh.[346] The list is estimated to be from the 1980s which is the same timeline as the earlier discussed Tax Haven Information Books.[347] The IRM did not have a specific definition of a tax haven but it did present criteria that described a tax haven.[348] However, a copy of this could not be found to examine the characteristics presented.

[344] IRS, *Tax Haven Information Book,* Doc. 6743(2-82) (U.S. Gov't Printing Office, 1982) *found at* https://catalog.hathitrust.org/Record/101663072; *See also*, IRS, *Tax Haven Information Book*, Doc. 6743 (4-84) (U.S. Gov't Printing Office, 1984).
[345] These books as mentioned earlier in this chapter are not mandatory law. They are only persuasive in nature and do not hold any legal authority.
[346] Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven,* 44 Econ. & Soc. Rev. 401, 419 (Autumn 2013).
[347] Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven,* 44 Econ. & Soc. Rev. 401, 419 (Autumn 2013).
[348] Gary Tobin and Keith Walsh, *What Makes a Country a Tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven,* 44 Econ. & Soc. Rev. 401, 419-420 (Autumn 2013).

3.3.4. GOVERNMENTAL ACCOUNTABILITY OFFICE

The U.S. Government Accountability Office (hereinafter referred to as "GAO") provides non-partisan reports and testimonies to Congress in order to "*improve government and save taxpayers billions of dollars*."[349] The GAO has issued multiple reports or provided testimonies reaching back as early as 1979 that analyzes tax havens and the corresponding issues that takes into consideration the problems with tax evasion. Some of these reports contain lists of tax haven jurisdictions (or definitions) but reports that do refer to the OECD's list of tax haven jurisdictions.[350]

The GAO published a report in 1979 titled Problem of Tax Evasion and Tax Avoidance in Tax Haven Countries but despite the use of the term tax haven in the title there was no list or a reference to a list that would identify what this report would consider a tax haven. The report concerned tax treaties and the confidentiality clause contained within the tax treaties that restricted those who had access to the exchanged tax information.[351] Tax havens were not specifically addressed via a blacklist or definition.[352]

[349] GAO, *What GAO Does*, https://www.gao.gov/about/what-gao-does/

[350] GAO, *International Taxation: Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting*, GAO-04-856 (June 2004); *See also*, GAO, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars but May Be Missing Continued Evasion*, GAO-13-318 (March 2013); GAO, *Tax Compliance: Challenges in Ensuring Offshore Tax Compliance*, GAO-07-823T (March 2007); GAO, *Problem of Tax Evasion and Tax Avoidance in Tax Haven Countries*, B-137762.42 (May 29, 1979); GAO, *Federal Efforts to Define and Combat the Tax Haven Problem: Statement of William J. Anderson, Director, Before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives* (April 12, 1983).

[351] GAO, *Problem of Tax Evasion and Tax Avoidance in Tax Haven Countries*, B-137762.42 (May 29, 1979).

[352] GAO, *Problem of Tax Evasion and Tax Avoidance in Tax Haven Countries*, B-137762.42 (May 29, 1979).

In 1983, the GAO released the statement that the director of the GAO delivered to Congress regarding the federal efforts to define tax havens.[353] The testimony he gave was based on work the IRS did in order to "*detect and deter tax law abuses relating to tax havens*."[354] The report contained a definition which had six elements — of which low or no tax rate and secrecy were the first two — that were reflective of the elements found in the Gordon Report.[355]

A 2004 report, Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting, referenced the OECD's tax haven list as did a 2007 report but contained no reference to any other lists.[356]

In a July 2008, a GAO report titled Cayman Islands: Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist studied the nature of U.S. persons' and corporate business activities in the Cayman Islands.[357] This report identified the Cayman Islands as an offshore financial center (OFC) instead of as a tax haven. Following this identification as an OFC, the report noted that the jurisdiction has no direct taxes and a high volume of non-residential financial activity. The authors also attempt to define OFCs while acknowledging that those types of jurisdictions are not easily defined. This is the identical argument used when trying to

[353] GAO, *Federal Efforts to Define and Combat the Tax Haven Problem: Statement of William J. Anderson, Director, Before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives* (April 12, 1983).

[354] GAO, *Federal Efforts to Define and Combat the Tax Haven Problem*: Statement of William J. Anderson, Director, Before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives (April 12, 1983).

[355] GAO, *Federal Efforts to Define and Combat the Tax Haven Problem*: Statement of William J. Anderson, Director, Before the Subcommittee on Commerce, Consumer and Monetary Affairs, Committee on Government Operations, House of Representatives (April 12, 1983).

[356] GAO, *International Taxation: Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting*, GAO-04-856 (June 2004); See also, GAO, *Tax Compliance: Challenges in Ensuring Offshore Tax Compliance*, GAO-07-823T (March 2007).

[357] U.S. Government Accountability Office, *Cayman Islands: Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist*, GAO-08-778 (July 2008).

define tax havens. Despite the difficulty defining the concept of an OFC, they define an OFC in very broad terms as a jurisdiction that has "*a high level of non-resident financial activity, and may have characteristics including low or no taxes, light and flexible regulation, and a high level of client confidentiality*."[358] The last part of that definition includes the classical criteria of tax haven definitions.

Five months later another report by the GAO, which was given to members in Congress, reinforces the idea that the United States does not have an official definition of what a tax haven is nor can a consistent definition be drafted.[359] They acknowledged that there is no "*agreed-upon*" definition or list and that they chose not to develop their own list or definition. Instead, the GAO chose to combine three different lists of tax havens for the purpose of identifying tax havens for the report.[360] The purpose of the report was not to develop a list or a definition but because there is no official definition within the U.S. government, the GAO had to be creative and look elsewhere. The three lists selected were contained in the OECD list, a working paper by Dharmapala and Hines and a District Court order granting permission for the IRS to serve John Doe summons (Chapter 6) which identified a list of tax haven jurisdictions.[361] It would have been impossible for the GAO to complete the report without a list of jurisdictions, however, the report cites concerns from the Deputy Assistant Secretary of the Treasury. The Assistant Secretary, while noting that tax evasion is taken very seriously by the Treasury Department, conveyed concern that

[358] U.S. Government Accountability Office, *Cayman Islands: Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist*, GAO-08-778 (July 2008).
[359] U.S. Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed As Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008); also discussed in Gary Tobin and Keith Walsh, *What Makes a Country a tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 403 (Autumn 2013).
[360] U.S. Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed As Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008); also discussed in Gary Tobin and Keith Walsh, *What Makes a Country a tax Haven? An Assessment of International Standards Shows Why Ireland is Not a Tax Haven*, 44 Econ. & Soc. Rev. 401, 403 (Autumn 2013).
[361] U.S. Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed As Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008).

the GAO had used a blacklist when there is no agreed-upon definition of tax havens or lists of jurisdictions.[362]

A 2013 GAO report referred to multiple sources for a list of jurisdictions when discussing tax havens. It referenced in the footnotes the report mentioned just above which lists the OECD list, the National Bureau of Economic Research list and a John Doe Summons.[363] But again, this is not the U.S.' list and there is no attempt at defining what a tax haven to justify using those lists.

Despite all the various unofficial definitions and blacklists found in the legal sources[364], the United States government's various agencies and departments have not been able to find a strong solution in the use of blacklists or a precise definition through other legal resources in order to address the issue of tax havens.

3.4. REAL ISSUE: SECRECY

The real problem that tax havens present when dealing with the IRS' inability to procure taxpayers' information on their foreign accounts is not that a definition cannot be drafted or that blacklists are almost as equally difficult to draft – this is just a distraction diverting from the real issue. The genuine obstacle is that many jurisdictions – not all are identified as tax havens on the various lists[365] - have laws and regulations that allow for the accounts to be concealed behind the veil of secrecy laws. This veil of secrecy, the symptom that needs to be treated, makes it almost impossible for the IRS to procure taxpayers' accounts abroad so that tax laws can be

[362] U.S. Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed As Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008).
[363] GAO, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars but May Be Missing Continued Evasion*, GAO-13-318 (March 2013).
[364] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 791 (2013).
[365] For reference, see the EU list published in December of 2017 and the past OECD list which can also be found in Appendix B in a comparative spreadsheet.

administered correctly and fairly. As Nicholas Shaxson states, secrecy is the main mechanism[366] that allows for people to hide their financial assets. Senator Levin, too, noted that the target is offshore tax abuses that are facilitated by secrecy laws in foreign jurisdictions – not the actual jurisdiction alleged to be a tax haven - that allow taxpayers to avoid paying tax.[367] The difficulty of and inability to come to a consistent definition of what a tax haven is or to draft a blacklist as well as knowing that secrecy is the real problem is evidence that another approach is necessary.

Consequently, if governments cannot procure the information they need to administer tax laws correctly and fairly because of secrecy laws that exist in certain countries, what is the outcome? How does a government penetrate the secrecy, or can a government penetrate it? The following chapters demonstrate that the United States has attempted to do just that, and they detail what methods the U.S. government has employed to pierce the veil of secrecy to obtain information on U.S. taxpayers' foreign accounts.

Despite the above, the section dealing with attempted legislation shows that at least some members of the U.S. Congress would like to employ a tax haven blacklist or a set of criteria that defines what qualifies as a tax haven jurisdiction. The problem with that is that definitions and blacklists do not solve the inability to procure information on U.S. taxpayers' foreign accounts. If the United States would like to use a list of jurisdictions, a more constructive way, perhaps, would be to draft a list of jurisdictions that have impenetrable secrecy laws where obtaining information in the past has been difficult. The list should not be used to punish foreign jurisdictions but should look to the taxpayer and where their accounts are located. The focus should not be about shaming or bankrupting a jurisdiction into cooperating but, instead, it should focus on changing the behavior of the taxpayer who utilizes the secrecy of the jurisdiction to evade their tax responsibilities. Although tax haven blacklists and definitions are typically employed to change the behavior of the alleged tax haven jurisdiction, the

[366] Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men Who Stole the World*, 8-9 (Penguin Random House, 2016).
[367] 111th Cong. Rec., Vol. S.2624 (March 2, 2009).

U.S should use their list (should they employ one) to change the behavior of the taxpayer – to encourage compliance - because the U.S. government does not have control over foreign jurisdictions but it does have control and influence over their own taxpayers which should be used to their advantage in getting taxpayers to comply.

Nor should the list be an arbitrary list, as Jason Sharman and Gregory Rawlings argue, but rather, a list should be backed up by solid criteria and formal procedures that are updated and changed as needed. For example, the list could be drafted and updated/reviewed and in between the updates the jurisdictions in question could have a right to appeal the designation as a tax haven. It does no good to have a blacklist that was created on a whim that has no solid evidence backing up why those countries were placed on the blacklist. This list – should the U.S. want to utilize a well-reasoned one – should be based on what countries they find present the biggest threat to procuring taxpayer information through the use of the current anti-tax evasion measures that are discussed in the rest of the thesis. Then U.S. taxpayers should be informed that any accounts that are held in those countries will be inspected more closely and non-disclosure will include greater penalties and prosecution beyond what exists in the anti-tax evasion measures currently.

Two places the U.S. might consider using a well-reasoned tax haven definition or blacklist would be within the Qualified Intermediary program (See Chapter 7) and the Foreign Account Tax Compliance Act (FATCA – Chapter 9). The IRS – in creating the QI program – noted that the jurisdictions that refused to cooperate with the program and were considered tax haven jurisdictions (or bank secrecy jurisdictions) needed more stringent oversight over the FFIs or their branches located in those jurisdictions.[368] For this scenario, a tax haven definition or a blacklist could help in identifying those jurisdictions where the FFIs need more oversight and also provide some incentive for the FFIs to fully cooperate with the program if they know they will

[368] IRS Rev. Proc. 2017-15; *See also,* IRS Announcement 2000-48, 2000-1 C.B. 1243; Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

be under more scrutiny because of the secrecy their jurisdiction provides to those looking for it.

The anti-tax evasion measures discussed in the rest of the thesis are designed not to target tax havens but, instead, are devised to lift the veil of secrecy that many jurisdictions have so that the U.S. government can procure taxpayer information on foreign accounts to administer the tax laws correctly and fairly. The Gordon Report, as acknowledged earlier, called for a coordinated federal attack on the use of tax havens and that should continue to be the game plan, however, instead of tax havens, the coordinated attack should be on the secrecy. The following chapters will explore the U.S. measures that address the inability to procure taxpayer information due to the taxpayers' use of secrecy laws so that IRS can administer the tax laws fairly and correctly, how those measures are implemented and whether the anti-tax evasion measures do in fact help the IRS procure the information needed from U.S. taxpayers' foreign accounts so that the tax law can be administered fairly and correctly.

CHAPTER 4. REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS

4.1. INTRODUCTION

The United States' domestic federal tax system is a system that has two components. The first component is the U.S. taxpayers' voluntary compliance and self-assessment of federal taxes owed to the IRS.[369] The second is a federal withholding procedure that enforces the taxpayer's self-assessment and compliance.[370] Employers are required to withhold a certain portion of the taxpayer's wages which are then sent to the IRS and are applied towards the taxpayer's federal tax liability.[371] This system, which has its shortcomings that can be seen in acts such as non-filing, underreporting and underpayment[372], has shown that "withholding has proven to be the single most effective enforcement mechanism for collecting taxes on income from labor".[373] While this withholding system has worked fairly well at the domestic level, there is no international withholding system[374] that is similar.[375] Therefore, in order to enforce

[369] Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 155, 158 (2013); See also, McKay, Samantha, "*The Foreign Account Tax Compliance Act: A Constitutional Analysis"* 2 (2018). *Law School Student Scholarship*. 944.
[370] McKay, Samantha, "*The Foreign Account Tax Compliance Act: A Constitutional Analysis"* 2 (2018). *Law School Student Scholarship*. 944.
[371] McKay, Samantha, "*The Foreign Account Tax Compliance Act: A Constitutional Analysis*" 2 (2018). *Law School Student Scholarship*. 944.
[372] Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 155, 158 (2013)
[373] Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 155, 158 (2013) (quoting Lily Kahng, Investment Income Withholding in the United States and Germany, 10 Fla. Tax Rev. 315, 323 (2011)).
[374] FATCA, the Foreign Account Tax Compliance Act, discussed in Chapter 9 may change this. At the very least it would be a quasi-international withholding system. Following in its footsteps is the OECD's CRS, Common Reporting System.
[375] Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 155, 158 (2013)

compliance on foreign accounts and incomes offshore, the IRS and the Department of the Treasury have used their anti-tax evasion framework which is comprised of law, regulations and administrative programs aimed at reducing tax evasion and increasing tax compliance. Under U.S. tax law, it is legal for U.S. persons to hold money and assets offshore in financial accounts, but U.S persons are required to report any control over accounts that are valued (at any point during the year) in excess of $10,000 USD.[376] While it is legal to have offshore accounts, it is not legal to willfully evade taxes. 26 U.S.C. §7201 defines the attempt to evade or defeat tax as "*any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony*….."[377] 26 U.S.C. §7201 does not address the unintentional or inadvertent evasion of taxes; it only addresses the intentional evasion by taxpayers. However, the FBAR, as shown in subsection 4.3.6, penalizes non-willful, unintentional non-reporting.

The problem of tax evasion occurs and is facilitated when a few factors come into play according to the Government Accountability Office. First, limited transparency (secrecy) of accounts and assets plays a part. The limited transparency makes it difficult to procure information needed in order to assess if taxes were properly paid and, therefore, makes tax evasion difficult to detect.[378] This is the main issue when trying to administer the laws and regulations to taxpayers when they have foreign accounts but do not voluntarily comply.

Second, U.S. taxpayers have an obligation to self-report any income or accounts from foreign jurisdictions, however, third parties in foreign jurisdictions do not have the

[376] 31 C.F.R. §1010.306; See also, GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009); Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[377] 26 U.S.C. §7201.
[378] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).

same obligation to report taxpayers income and accounts to the IRS.[379] Interestingly, but unsurprisingly, the IRS found that when third parties are not required to report income, taxpayers include less than one-half of their income on tax returns.[380] When a taxpayer does end up self-reporting, this information is not easily verifiable due to multiple reasons including the lack of transparency and the lack of obligation of third-party reporting.[381]

The third factor comes into play when financial advisors who facilitate tax evasion offer various types of schemes and abusive transactions.[382] These various schemes are easy, quick and cheap to set up and typically result in super complex structures that allow income and assets to evade detection by the IRS.[383]

All these issues establish, as the GAO found, both enforcement and oversight issues. So, how does a government solve these types of issues? Who do they target to help enforce compliance? The taxpayers? Third parties? Financial institutions? They all have a part to play in the enforcement as will be shown in the following chapters. To address the various moving parts, the federal government has an anti-tax evasion framework in place – as discussed in this chapter and the following chapters – to try to target tax evasion and bring taxpayers into compliance.

This chapter, however, specifically focuses on the taxpayer and utilizing the FBAR to enforce compliance. The Report of Foreign Bank and Financial Accounts (hereinafter referred to as FBAR) is one of the earliest pieces of the framework that the United States has enacted in order to procure information on U.S. taxpayers' foreign accounts. A 2011 estimate suggested that five to seven million U.S. resident taxpayers

[379] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).
[380] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).
[381] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).
[382] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).
[383] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 4 (March 2009).

(which includes U.S. citizens overseas) and tens of millions of non-resident taxpayers were subject to the FBAR requirements yet only 741,000 taxpayers actually filed an FBAR.[384]

This chapter will first discuss the legislative history of the FBAR, an anti-tax evasion measure, to introduce the measure and discusses briefly the purpose of the act. The chapter then moves onto how the FBAR measure is implemented with the goal of procuring information on U.S. taxpayers' foreign accounts in mind. This section also includes an explanation of the FBAR penalty scheme which is the enforcement mechanism that is in place to compel U.S. taxpayers to comply. The concluding section contemplates two questions. First, does the FBAR successfully procure U.S. taxpayer information on foreign accounts so that the IRS has the information it needs to correctly and fairly administer the tax law? The second question – only answered if the answer to the first question is no – is if the FBAR does not help in obtaining the information needed what can be done to improve the FBAR so that the chance to obtain information increases?

4.2. FBAR LEGISLATIVE HISTORY

One of the measures that the IRS uses to compel a taxpayer to self-report[385] (as well as being as predecessor to FATCA) is the FBAR which is required under the Bank Records and Foreign Transactions Act, also known as the Bank Secrecy Act

[384] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 380 (Palgrave MacMillan 2016).
[385] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 5 (March 2009).

(hereinafter referred to as "BSA"), which was enacted in 1970[386] and amended the Federal Deposit and Insurance Act.[387] This chapter is concerned with Title II, the Currency and Foreign Transactions Reporting Act, of the BSA under which the FBAR falls. In 1982, this part of the Act was re-enacted with little change and is now called Records and Reports on Monetary Instruments Transactions which is found at 31 U.S.C. § 5311 through 5322.[388] The subsequent Treasury Regulations regulating and providing guidelines for the FBAR are found at 31 C.F.R. §1010.

The purpose of the BSA was twofold but this thesis is only concerned with the second purpose which is found in Title II of the original bill.[389] Title II addressed the use of foreign financial institutions located in jurisdictions that have secrecy laws by American citizens and residents in order to conceal assets.[390] The BSA focused on two issues that interfered with the ability to investigate and prosecute financial crimes

[386] United States Senate, Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, S. Rep. 91-1139 (August 24, 1970); *See also*, FinCEN, *FinCEN's Mandate from Congress, found at* https://www.fincen.gov/resources/statutes-regulations/fincens-mandate-congress; Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015); Stephan Michael Brown, *One Size Fits Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243, 245 (2014); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 362 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 3 (July 4, 2009); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 17 (January-February 2015).

[387] 91 Cong. Rec. 16950 (May 25, 1970).

[388] Department of Justice, *Overview of the Bank Records and Foreign Transactions Act, found at* https://www.justice.gov/jm/criminal-resource-manual-2029-overview-bank-records-and-foreign-transactions-act

[389] 91 Cong. Rec. 16950 (May 25, 1970); *See also*, DSC Risk Management Manual of Examination Policies, *Bank Secrecy Act, Anti-Money Laundering and Office of Foreign Assets Control*, 8.1-1 (2005) *found at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf

[390] 91 Cong. Rec. 16950 (May 25, 1970); *See also*, DSC Risk Management Manual of Examination Policies, *Bank Secrecy Act, Anti-Money Laundering and Office of Foreign Assets Control*, 8.1-1 (2005) *found at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf

such as tax evasion.[391] The particular issue that this thesis is concerned with is the second issue: taxpayers' use of foreign bank accounts in jurisdictions that have enacted strict secrecy laws[392] which constrains the IRS' ability to access the information needed to apply the tax laws correctly.

Even in the 1970s, both law enforcement and the IRS were struggling to access information about foreign accounts that are held by U.S. taxpayers abroad and the process to gain the information that they were searching for was a long, drawn-out operation.[393] Representative Wright Patman, who was behind the legislation, pointed out that the simplest device or structure was easiest when using a secret bank account because the "*law enforcement people can't find you anyway*".[394]

The intent of the BSA, according to Rep. Patman, was neither to interfere with the rights, laws or sovereignty of the foreign nations nor to interfere with the flow of international commerce.[395] This stance seems in stark opposition to the intent of the more current legislation targeting overseas accounts held by U.S. taxpayers, FATCA, which is discussed in chapter 9. This bill was only meant to target American citizens and residents and those doing business in the United States who utilized secret foreign accounts to commit criminal actions including, but not limited to, tax evasion and anti-money laundering (also known as AML).[396] One objective was to put a taxpayer who

[391] United States Senate, Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, S. Rep. 91-1139 (August 24, 1970); *See also*, FDIC, *The Bank Secrecy Act: A Supervisory Update, found at* https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum17/si-summer-2017-article02.pdf
[392] United States Senate, Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, S. Rep. 91-1139 (August 24, 1970); *See also*, FDIC, *The Bank Secrecy Act: A Supervisory Update, found at* https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum17/si-summer-2017-article02.pdf
[393] 91 Cong. Rec. 16950 (May 25, 1970); *See also*, Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009).
[394] 91 Cong. Rec. 16952 (May 25, 1970).
[395] 91 Cong. Rec. 16950 (May 25, 1970).
[396] 91 Cong. Rec. 16950-16952 (May 25, 1970).

utilized the secret foreign accounts on the same footing as he would be with his domestic U.S. account.[397]

Originally, the intent was to draft a simple piece of legislation that would have made secret accounts illegal unless the taxpayer completely disclosed,[398] however, lawmakers decided this was not the approach to take due to the possible effects on the other areas of the law.[399] The bill was designed to target American taxpayers and their foreign accounts; it had no intention of targeting institutions and persons abroad.[400]

The purpose of the specific requirement to file an FBAR was to require financial institutions to obtain certain information in order for the government to be able to utilize them in support of criminal and tax evasion investigations.[401] The requirement of the bill obliged any U.S. citizen, resident or anyone doing business in the U.S. who engages in any transaction with a foreign financial institution to maintain records or to file reports detailing specific, required information.[402]

Representative Wright Patman pointed out in his statement in front of House that the purpose was not to defame a specific nation, to interfere with other nations' domestic

[397] 91 Cong. Rec. 16950 (May 25, 1970).
[398] 91 Cong. Rec. 16951 (May 25, 1970).
[399] 91 Cong. Rec. 16951 (May 25, 1970).
[400] 91 Cong. Rec. 16951 (May 25, 1970).
[401] United States Senate, Committee on Banking and Currency, *Foreign Bank Secrecy and Bank Recordkeeping*, S. Rep. 91-1139 (August 24, 1970); *See also*, FDIC, *The Bank Secrecy Act: A Supervisory Update, found at* https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum17/si-summer-2017-article02.pdf; *See also,* Stephan Michael Brown, *One Size Fits Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243, 245 (2014); Tracy A. Kaye, *Innovations in the War on Havens*, 2014 BYU L. Rev. 363, 367 (2014); *See also*, Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333, 337 (Spring 2015); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 362 (Palgrave MacMillan 2016); *See also*, DSC Risk Management Manual of Examination Policies, *Bank Secrecy Act, Anti-Money Laundering and Office of Foreign Assets Control*, 8.1-1 (2005) *found at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf; Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 3 (July 4, 2009).
[402] 91 Cong. Rec. 16950 (May 25, 1970).

policy or to interrupt the flow of international commerce but simply to prevent Americans from using the secret foreign accounts to break or avoid U.S. law.[403] While the purpose was not defame any one nation, Swiss bank secrecy was a point of discussion on the House floor as one of the countries that was known for its secrecy laws noting that the Swiss have had a long history of secrecy laws.[404] Patman also pointed out numerous cases illustrating the use of secret bank accounts that were used to violate U.S. law in order to highlight the need for the FBAR legislation.[405] This is reflective of the circumstances surrounding the UBS (and others) bank scandal of 2008 so it seems much had not changed between 1970 and 2008 despite the FBAR requirement and the other programs used to address this very issue which are discussed in the following chapters.

Researching legislative history behind the FBAR reveals that there were not many changes until enactment of the 2004 American Jobs Creation Act.[406] The 1980s produced relatively minor changes other than to re-enact the legislation and change the name of the Act. In 2001, after the September 11th terrorist attacks, Congress focused its attention on terrorism and the money laundering that funded the terrorism by expanding the purpose of the FBAR. The purpose was to include "the conduct of intelligence or counter-intelligence activities, including analysis, to protect against international terrorism"[407] by passing the Patriot Act.[408] While the focus of the Patriot Act was on money laundering and terrorism, it did change the FBAR by requiring improved FBAR enforcement since the illegal offshore banking services provided a haven to money launderers and terrorists and protected their assets.[409] The change

[403] 91 Cong. Rec. 16951-16952 (May 25, 1970).
[404] 91 Cong. Rec. 16952 (May 25, 1970).
[405]91 Cong. Rec. 16952 (May 25, 1970).
[406] http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/
[407] Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[408] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009); *See also*, http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/; *See also*, Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[409] http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/

also required the Department of Treasury to recommend improvements to both the policies and procedures of the FBAR.[410]

In between the 2001 Patriot Act change and the subsequent legislation in 2004, the Treasury issued three consecutive reports in response to Congress' request.[411] The first report that was given in April of 2002 showed, some 32 years after the passage of the BSA, that compliance with the FBAR was extremely low.[412] The IRS estimated that roughly one million U.S. taxpayers had either control of or signatory authority over a foreign bank account and the percentage of those that were in compliance with the FBAR was below 20%.[413] The reason stated was that enforcement efforts were insufficient due to multiple reasons not least of which was accessing information on accounts held abroad.[414] The report identified goals that would improve the FBAR compliance and it delegated the enforcement of the FBAR to the IRS.[415] The first report also discovered two groups to address: taxpayers who did not know about the requirement to file FBARs and those who did not file FBARs in order to hide

[410] http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/
[411] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 12 (2006).
[412] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 12 (2006); *See also*, Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[413] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 12 (2006) (quoting the 2002 Treasury Report, U.S. Dep't of the Treasury, A Report to Congress In Accordance With §361(b) of the Uniting and Strengthening American by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) 12 (April 26, 2002).
[414] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 12 (2006) (quoting the 2002 Treasury Report, U.S. Dep't of the Treasury, A Report to Congress In Accordance With §361(b) of the Uniting and Strengthening American by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) 12 (April 26, 2002); See also, Martin R. Press and Nathan W. Hill, FBAR PENALTIES and U.S. v. Zwerner, 41 Int'l Tax J. 18 (January-February 2015); Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[415] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 14 (2006); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).

income.[416] The second report came a year later in April 2003 and described the progress in addressing the issues found in the first report.[417] It indicated that improvement had been made with the IRS investigating FBAR violations and the DOJ and FinCEN enforcing it.[418] The IRS was then granted the enforcement authority over the FBAR because "*it has more resources than FinCEN that can be devoted to enforcement, the FBAR is more directed toward tax evasion….and most FBARs are filed by individuals, not financial institutions.*"[419] The third and final report (2005) described the mechanisms that the IRS had put into motion to administer and improve compliance with the FBAR including an educational campaign to help publicize the FBAR and the requirements taxpayers need to meet in order to be in compliance.[420] The report also reflected that the compliance rates had increased between 2000 and 2003 by 17% but acknowledged that some of the increase had to do with voluntary programs such as the Offshore Voluntary Compliance Initiative (discussed in the next chapter) because taxpayers, under these programs, were required under these programs to file outstanding FBARs.[421]

Originally, the penalty was a maximum of $1,000.00 dollars for failure to report a foreign account but this amount was changed in 1982 to reflect a maximum of $100,000 or 50% of the value in the account at the time of the violation whichever was less.[422] The next major change to the FBAR occurred in the passing of the

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[416] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 14 (2006).
[417] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 15 (2006).
[418] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 15 (2006).
[419] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 16 (2006); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[420] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 16-17 (2006).
[421] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 17 (2006).
[422] Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 17 (January-February 2015).

American Jobs Creations Act in 2004[423] and this was done in response to Congress' indignation at the low compliance rates. The Jobs Act made several changes to the FBAR process.[424] One change significantly increased civil penalties up to $10,000 per non-willful violation[425] and increased the civil penalty for *willful* violations to $100,000 *or* 50 percent of the amount of the transaction whichever is greater which could make the taxpayer accountable for three times the amount of account.[426] The Treasury was given considerable discretion to determine the penalties and in turn delegated that authority to the IRS.[427] Significantly, the Jobs Act also shifted the burden of proof from the IRS to the taxpayer to prove via the reasonable cause exception that they did not violate the law.[428] The reason for these dramatic penalty increases was to dangle harsh penalties in front of the taxpayer to force the disclosure of their foreign financial accounts so that the IRS can apply the tax laws fairly and correctly.[429]

The statute that directed the Secretary of the Treasury to adopt the FBAR was 31 U.S.C. §5314 and was followed by the regulation 31 C.F.R. §1010.350 which describes and defines in more detail what is required. The other resource to examine

[423] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 18 (2006).
[424] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 18 (2006).
[425] 31 U.S.C. §5321(a)(5)(i); *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 18 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 17 (January-February 2015).
[426] 31 U.S.C. § 5321(a)(5)(C); *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 18 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[427] Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 17 (January-February 2015).
[428] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 19 (2006); 31 U.S.C. §5321 (a)(5)(B()(ii).
[429] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 98 (2006).

when trying to understand the FBAR is the actual document and the instructions that accompany it.[430]

4.3. IMPLEMENTATION OF THE FBAR

The next section will focus on how the FBAR measure is implemented in order to procure the information the IRS needs on U.S. taxpayers' foreign accounts so that they can administer the tax laws correctly and fairly? How does a U.S. taxpayer know if they are required to file an FBAR?

A taxpayer has to meet four out of five elements in order for the requirement of filing an FBAR, FinCEN Report 114[431], to kick in.[432] The five elements are: a U.S. taxpayer, a financial interest or signatory authority, a foreign financial account and an aggregate amount of $10,000 USD or more.[433] Among academic articles there is a discrepancy as to the number of criteria to be met by those who need to file an FBAR. The Internal Revenue Manual (IRM) itself lists four criteria but uses the word "*or"* to described one criterion where it should be two.[434] The author of this thesis believes the five criteria listed below covers what is required by the FBAR because the other academics use descriptive words that describe the actual element instead of addressing just the

[430] Department of Treasury, *FBAR, found at* https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; *See specifically,* https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

[431] Department of Treasury, *FBAR FAQ, found at* https://bsaefiling.fincen.treas.gov/docs/FBAR_EFILING_FAQ.pdf (formerly known as TD F. 90-22.1)

[432] 31 C.F.R. §1010.350; See also, Jeffery D. Moss, *Foreign Bank Account Reports: Will There Be More Scrutiny of FBARS and Other Disclosure Returns*?, 31 Foreign Bank Account Reports 29 (Spring 2018);

[433] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 5 (July 4, 2009); *See also,* http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/

[434] Internal Revenue Manual, 4.26.16.3 (11-06-2015).

elements needed.[435] The justification for the five criteria is that neither the descriptors, *U.S.* and *foreign* – describing the persons (element 1) and the types of financial accounts (element 3) that fall under the FBAR – are separate elements because they are just that – descriptors. The wording "*or*" used for the financial interest criterion suggests that it should be divided into two criteria – *financial interest in OR signatory authority over* one or more financial accounts – and not one. The final criterion, the aggregate amount, has been divided into different criteria but should not be separated as the $10,000 amount and phrasing "*calendar year*" simply describe the total dollar amount that the aggregate amount should be as well as the timing for when the aggregate amount occurs. The analysis of the FBAR in this thesis is based on the five elements because the other suggested criteria (from other scholars) are based on descriptors that simply describe the stated criteria.

4.3.1. U.S. PERSON

According to 31 C.F.R. § 1010.350, a *U.S. person* who has a financial interest in, or signature or other authority over a foreign financial account that has an aggregate value of $10,000 at any time during the calendar year meets the first criterion.[436] A. U.S. person is defined as a citizen or resident of the United States or an entity created, organized or formed under the laws of the United States.[437] A U.S. citizen is a person

[435] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 5 (July 4, 2009); *See also*, http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/; D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 366-371 (Palgrave MacMillan 2016).

[436] 31 C.F.R. § 1010.306 (c); 31 C.F.R. 1010.350 (a); *See also*, Charles P. Rettig, *Why the Ongoing Problem with FBAR Compliance*, J. Tax & Proc. 37, 39 (August/September 2016); Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).

[437] 31 C.F.R. 1010.350 (b)(1)-(3).; *See also;* Internal Revenue Manual, 4.26.16.3.1 (11-06-2015); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

that has either a U.S. birth certificate or naturalization papers.[438] Residency does not define U.S. citizenship.[439] A U.S. entity is a legal entity formed under the laws of the U.S. or its possessions and territories.[440] An U.S. entity is defined (but not limited to) a corporation, partnership, trust or limited liability company.[441] A person is defined in the FBAR instructions as an individual, including a minor, and legal entities including but not limited to, a LLC, corporation, partnership, trust, or estate.[442] The definition of entities in the regulations leave open the ability to include new types of legal entities in the future.[443]

Originally, the FBAR only applied to U.S. citizens and residents who permanently lived in the U.S. but the new regulations were expanded to include the new class identified under the United States Code – tax residents.[444] The tax resident definition has extended the identification as a U.S person for - tax purposes - to include a resident of the U.S. who is either a green-card holder or one who meets the substantial presence test.[445] The substantial presence test states that an individual is a U.S. resident for tax purposes if the individual is physically present in the U.S. for 31 days during the

[438] Internal Revenue Manual, 4.26.16.3.1.1 (11-06-2015).
[439] Internal Revenue Manual, 4.26.16.3.1.1 (11-06-2015).
[440] Internal Revenue Manual, 4.26.16.3.1.3 (11-06-2015).
[441] 31 C.F.R. §1010.350(b)(3); *See also*, Internal Revenue Manual, 4.26.16.3.1.3 (11-06-2015).
[442]FINCEN, *Filing Instructions*, https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf
[443] Internal Revenue Manual, 4.26.16.3.1.3 (11-06-2015).
[444] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 367 (Palgrave MacMillan 2016); See also, Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 5 (July 4, 2009).
[445] 75 Fed. Reg. 8844 (2010); *See also*, 26 U.S.C. 7701(b); 31 C.F.R. 1010.350(b); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 367 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 5 (July 4, 2009); IRS, *Introduction to Residency Under U.S. Tax Law*, *available at*, https://www.irs.gov/individuals/international-taxpayers/introduction-to-residency-under-us-tax-law

current year and 183 days total during a 3-year period that includes the current year and the two years immediately prior to that.[446]

The purpose behind the additional persons included in the definition was that it provides uniformity among taxpayers but also "*takes into account that individuals may seek to hide their residency in an effort to obscure the source of their income or location of their assets.*"[447]

4.3.2. FINANCIAL INTEREST

The next element that needs to be met is the financial interest element. When does the taxpayer have a financial interest? The first issue is to ask is it an indirect or direct interest and how to distinguish between the two types of interest.[448] A direct financial interest occurs when the person is an owner of record of or holds legal title to the account in question.[449] It does not matter whether the account is maintained for personal benefit or for the benefit of a third party.[450] If the account is jointly maintained or if multiple persons have an percentage of the interest, then each person

[446] IRS, *Substantial Presence Test, found at* https://www.irs.gov/individuals/international-taxpayers/substantial-presence-test
[447] 75 Fed. Reg. 8844 (2010), *available at,* https://www.federalregister.gov/documents/2010/02/26/2010-4042/financial-crimes-enforcement-network-amendment-to-the-bank-secrecy-act-regulations-reports-of
[448] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS,* University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009).
[449] Internal Revenue Manual, 4.26.16.3.3 (11-06-2015); *See also,* Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS,* University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf
[450] 31 C.F.R. 1010.350 (e)(1); 31 C.F.R. 1010.350 (b)(1)-(3); *See also,* Internal Revenue Manual, 4.26.16.3.3 (11-06-2015); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS,* University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

is considered to have a financial interest in the account and is required to file an FBAR.[451]

The second type, an indirect interest, occurs when the titleholder or owner falls within one of four categories[452]:

i) a person acting as an agent[453], nominee[454], attorney or in some other capacity on behalf of the U.S. person with respect to the account[455]

ii) a person is also considered to have a financial interest if the owner of record is a corporation, partnership or any other entity in which the U.S. person owns directly or indirectly more than 50% of the interest in profits or capital [456],

[451] Internal Revenue Manual, 4.26.16.3.3 (11-06-2015). The entire account is reported for each separate owner; it is not prorated.
[452] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); *See also,* https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf
[453] An agent in this context is a person who is authorized to act for another person in regard to the financial account and who is under control of another (usually the person who authorized them to act).
[454] A nominee is one (either person or entity) that is acting on behalf of another person as a representative (can be an agent).
[455] 31 C.F.R. 1010.350 (e)(2)(i); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 369 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf
[456] 31 C.F.R. 1010.350(e)(2)(ii); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 369 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

iii) a trust[457], if the U.S. person is the trust grantor and has an ownership interest in the trust[458], or

iv) is a trust in which the U.S. person has either a present beneficial interest in more than 50% of the assets or from which such person receives more than 50% of the current income.[459]

4.3.3. SIGNATORY AUTHORITY

Along with the direct and indirect interests, the FBAR is interested in the reporting of someone who has "*signature authority*" over a foreign account.[460] A person is considered as having signature authority or other authority over a foreign account if the individual, alone or together with another, controls the disposition of money, funds or assets held in a financial account by the direct communication – in writing or otherwise – to the person with whom the account is maintained.[461] For example, a company who designates authority – to the CEO, the CFO, the treasurer or comptroller – to take action on the company's bank accounts is an example of signatory authority.

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[457] A trust is a legal construct where a trustee (a fiduciary) holds legal title to property for the benefit of the beneficiary or beneficiaries.

[458] 31 C.F.R. 1010.350(e)(2)(iii); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 369 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

[459] 31 C.F.R. 1010.350 (e)(2)(iv); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 369 (Palgrave MacMillan 2016); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

[460] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

[461] 31 C.F.R. 1010.350 (f)(1); *See also*, FinCen Form 114; Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 6 (July 4, 2009).

4.3.4. FOREIGN FINANCIAL ACCOUNT

The fourth criteria that must be met that would require a taxpayer to file an FBAR is for the U.S. taxpayer to have a financial interest in *foreign financial account*. The definition of a foreign financial account is required to identify which types of accounts fall under the FBAR. The types of foreign financial accounts that are reportable on the FBAR are bank accounts, security accounts and other financial accounts.[462] Financial accounts that qualify as "*other financial accounts*" are accounts with a person that is in the business of accepting cash deposits as a financial agency, insurance or annuity policies that have a cash value, an account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association or an account with a mutual fund (or similar pooled fund or an investment fund).[463] The definition of 31 C.F.R. § 1010.350 (c)(1)-(3) includes, but is not necessarily limited to bank accounts, securities accounts, deposit accounts, mutual funds and in some instances, a foreign credit card.[464]

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[462] 31 C.F.R. 1010.350 (c)(1)-(3); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009).

[463] 31 C.F.R. 1010.350 (c)(3)(i)-(iv); *See also*, Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 7 (July 4, 2009); *See also*, https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[464] 31 C.F.R. 1010.350 (c) (1)-(3); *See also*, Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 7 (July 4, 2009) (quoting Tax Analysts, *Service Discusses Foreign Bank and Financial Accounts Report Penalty*, Tax Notes Today, 14-14, Jan 23, 2006).

Knowing what qualifies as a financial account, the next question is what qualifies as a foreign account.[465] It is any type of account listed in the previous paragraph whose financial interest is located outside the United States.[466] A foreign country is defined as all geographical areas located outside of the territory of the United States which includes its territories and insular possessions such as Guam and Puerto Rico.[467] According to the filing instructions, a branch of a foreign bank that is physically within the United States is not considered a foreign financial account.[468] However, the opposite must then be true Lawrence Lokken suggests although this is not clarified in the instructions: an account held in a foreign branch of a U.S. financial institution would be considered a foreign account.[469]

[465] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009); *See also*, https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[466] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009); *See also*, https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[467] 31 C.F.R. 1010.100 (hhh); *See also*, DSC Risk Management Manual of Examination Policies, *Bank Secrecy Act, Anti-Money Laundering and Office of Foreign Assets Control*, 8.1-6 (2005) *found at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf ; Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf

[468] https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[469] Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 2 (July 4, 2009).

There are ten exceptions for those who are required to file FBARS. These exceptions can be found in the filing instructions.[470] The ten exceptions for those not required to file an FBAR are:

1) Consolidated FBAR which is if a United States person that is an entity is named in a consolidated FBAR filed by a greater than 50 percent owner, such entity is not required to file a separate FBAR.
2) Certain foreign financial accounts jointly owned by spouses.
3) Correspondent or Nostro accounts.
4) A foreign financial account held by any governmental entity of the U.S.
5) A foreign financial account held by any international financial institution if the U.S government is a member.
6) Individual Retirement Account (IRA) owners or beneficiary whose IRA holds a foreign financial account.
7) Participants in and Beneficiaries of Tax-Qualified Retirement Plans whose retirement plan holds a foreign financial account.
8) In certain, limited instances, individuals who have signature authority over foreign financial account but who have no financial interest in the account.
9) A trust beneficiary with a financial interest described in (2)(e) of the financial interest definition is not required to report the trust's foreign financial accounts on an FBAR if the trust, trustee of the trust, or agent of the trust: (1) is a United States

[470]FBAR Filing Instructions, *found at* https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 8 (2006); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 7 (July 4, 2009); Report of Foreign Bank and Financial Accounts, https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar

person and (2) files an FBAR disclosing the trust's foreign financial accounts.

10) United States Military Banking Facility. [471]

A Nostro or correspondent account is an account that one bank holds for another.[472] When certain types of accounts are jointly owned by spouses, they are also an exception, as number 1 above denotes. More specifically, the FBAR electronic filing instructions states that a spouse of an individual who files an FBAR is not required to file a separate FBAR *if* all the financial accounts that the non-filing spouse is required to report are jointly owned with the filing spouse, the filing spouse files the FBAR correctly and on time and the filers have filled out and executed Form 114a which is the Record of Authorization to Electronically File FBARs.[473] An IRA, as noted in number six, also known as an Individual Retirement Account, is a savings or brokerage account to which a person may contribute up to a specified amount of earned income each year and the contributions are not taxed until the money is withdrawn after the person turns 59½.[474]

Many of the exceptions listed above are not required to file because they do not represent an elevated risk of tax evasion. For example, governmental entities and international financial institutions (International Monetary Fund, IMF) are not required to file. Neither are U.S. Military Banking Facilities even if those banking institutions are located outside the United States.

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[471] FBAR Filing Instructions, *found at* https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; *See also, Report of Foreign Bank and Financial Accounts,* https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 8 (2006); Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25, 7 (July 4, 2009).

[472] *See* https://www.investopedia.com/terms/c/correspondent-bank.asp

[473] FBAR Filing Instructions, *found at* https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf;

[474] Black's Law Dictionary, 7th edition (Editor Bryan A. Garner, 1999).

4.3.5. AGGREGATE BALANCE

The fifth and final element is whether the U.S. person who has a financial interest in a foreign account holds an aggregate balance of a certain amount in the foreign account. A U.S. person is required to file an FBAR (separate from the IRS tax return) if the foreign financial account they have a financial interest in has an aggregate value that exceeds $10,000 at any time during the year.[475] The tax code did not designate the aggregate amount in a statute instead the defined amount was established in the regulations and the FBAR instructions for filing.[476]

4.3.6. THE FBAR PENALTY SCHEME[477]

Once it has been determined that the taxpayer has an obligation to file an FBAR, how does the government enforce that obligation so that the taxpayer is more likely to comply by giving the IRS the information it needs to administer the law correctly and fairly? What are the consequences for non-compliance by the taxpayer? Congress wanted to make sure, especially after 9/11, that the consequences for not filing the

[475]Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism*, 21 ILSA J. Int'l & Comp. Law 333, 337 (Spring 2015); *See also*, DSC Risk Management Manual of Examination Policies, *Bank Secrecy Act, Anti-Money Laundering and Office of Foreign Assets Control*, 8.1-1 (2005) *found at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf; Lawrence Lokken, *The Big, Bad FBAR: Reporting Foreign Bank Accounts to the U.S. IRS*, University of Florida Legal Studies Research Paper No. 2009-25 (July 4, 2009); https://www.fincen.gov/sites/default/files/shared/FBAR%20Line%20Item%20Filing%20Instructions.pdf; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[476] 31 C.F.R. §1010.306(c); *See also*, FBAR Filing Instructions, *found at*, https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 7 (2006).

[477] See Chapter 2, Section 2.5.1 for a discussion on tax cases, court jurisdiction and appellate issues regarding federal tax issues.

FBAR were harsh hoping this would force taxpayers into a confession of their offshore accounts, and which would bring them into compliance with the tax laws.[478]

The Bank Secrecy Act has created a financial penalty scheme which is considered "*one of the most powerful anti-tax evasion tools*"[479] the IRS has at its disposal. Penalties can include civil or criminal penalties and prosecutions.[480] Among the civil penalties at its fingertips, the IRS may assess a non-willful or a willful failure to file penalty.[481] The civil penalties statute, 26 U.S.C. §5321(a), prior to the 2004 amendment, only punished willful violations and the penalty was the amount that was in the account up to $100,000 or $25,000 USD, whichever was greater.[482] This division between willful and non-willful is an important distinction which will be discussed in the immediate subsection below.

[478] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 17-18 (2006);
[479] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 371 (Palgrave MacMillan 2016).
[480] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 369 (Palgrave MacMillan 2016); *See also*, https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 10 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[481] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 371 (Palgrave MacMillan 2016).
[482] Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014); See also, Stephen Michael Brown, O*ne-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs and Suggestions for Increased Participation in Future Compliance*, 18 Chapman L. Rev. 243, 245 (2014); Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 10 (2006).

Civil penalties for failing to file the FBAR can carry a penalty of up to $10,000[483] for a non-willful violation.[484] An exception exists where reasonable cause is given for the violation.[485] If reasonable cause is established, then no penalty will be imposed.[486] To establish reasonable cause, the taxpayer must prove that they meet two elements: that the violation was due to reasonable cause and the amount of the transaction or the balance in the account at the time of the transaction was properly reported.[487]

For willful violations, the civil penalties that may be assessed are equal to the greater of $100,000[488] or 50% of the highest balance in the U.S. person's foreign account for each violation that occurred and for each year that was not filed up to the last six years.[489] According to guidance that the IRS issued under no circumstances will the total amount of penalty surpass 100% of the highest combined of all foreign financial

[483] Penalties for non-willful violations can be up to $12,663 due to inflation according to 31 C.F.R. 1010.821 (Penalty Adjustment and table)
[484] 31 U.S.C. § 5321 (a)(5)(B)(i); *See also*, https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 11 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015); Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[485] 31 U.S.C. § 5321 (a)(5)(B)(ii); *See also*, https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 11 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[486] 31 U.S.C. § 5321 (a)(5)(B)(ii); *See also*, https://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html; *See also*, Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 11 (2006); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[487] Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, And Why It Matters*, 7 Houston Bus. & Tax J. 1, 11 (2006).
[488] Penalties for non-willful violations can be up to $126,626 due to inflation according to 31 C.F.R. 1010.821 (Penalty Adjustment and table)
[489] Robert W. Wood, *FBAR Penalties: When Will IRS Let You Off With A Warning?* Forbes, June 4th, 2012, *available at* https://www.forbes.com/sites/robertwood/2012/06/04/fbar-penalties-when-will-irs-let-you-off-with-a-warning/#6c87bec5363c; *See also*, Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015); Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).

accounts for the years that are examined (up to six years), nonetheless, a penalty rate higher or lower than 50% can be assessed.[490] The Title 31 penalty scheme only establishes maximum penalty amounts so the IRS has the responsibility of determining the correct FBAR penalty based on the circumstances and facts of each individual case.[491] If the IRS determines there was a willful violation, the burden is on the IRS to prove the willfulness.[492] The taxpayer does not just face FBAR penalties, they can also face other types of civil penalties in conjunction with FBAR penalties.[493] For example, penalties for negligence or substantial understatement or fraud can be applied as well.[494]

The civil penalties do not preclude the possibility of criminal prosecution or criminal penalties[495] for violations such as tax evasion, committing fraud or making false statements.[496] Those penalties include a fine of up to $250,000 and not more than five

[490] United States Department of Treasury, *Memorandum for All LB&I, SB/SE, and TE/GE Employees: Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), found at: https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf ; See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 372 (Palgrave MacMillan 2016).
[491] United States Department of Treasury, *Memorandum for All LB&I, SB/SE, and TE/GE Employees: Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), found at: https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf
[492] United States Department of Treasury, *Memorandum for All LB&I, SB/SE, and TE/GE Employees: Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), found at: https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf
[493] United States Department of Treasury, *Memorandum for All LB&I, SB/SE, and TE/GE Employees: Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), found at: https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf ; See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 371 (Palgrave MacMillan 2016).
[494] United States Department of Treasury, *Memorandum for All LB&I, SB/SE, and TE/GE Employees: Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties* (May 13, 2015), found at: https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf ; See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 372 (Palgrave MacMillan 2016).
[495] See subsection 1.4.3 for a discussion on the distinction between civil and criminal penalties in the U.S. including an explanation of how both civil and criminal penalties can be brought against one taxpayer (citizen).
[496] 31 U.S.C. §5322; 26 U.S.C. § 7201; 26 U.S.C. 7206: *See* also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 372 (Palgrave MacMillan 2016).

years imprisonment (or both) unless the violation occurred with the abuse of another law or as part of a pattern of illegal activity – for example, weapons trafficking.[497] Those penalties increase to $500,000 and/or 10 years of imprisonment.[498] This was a way for the U.S. government to try to force those U.S. taxpayers that hold foreign financial accounts into self-reporting and as a way to try to pierce the veil of bank secrecy that surrounds many foreign jurisdictions. [499]

The FBAR penalties, which should only be applied in order to promote compliance with FBAR reporting requirements,[500] have been applied against foreign assets of U.S. citizens who have failed to file the FBAR form and have brought in $10 billion USD in as of October 16th, 2016.[501] While the fines and penalties are severe, especially the penalties regarding the willful violations - and it would seem that the average person would respond to that steep of a consequence - it seems there is large sector of taxpayers who do not believe this is a great enough incentive to report their foreign accounts and income. This is reflected in the oft-quoted $458 billion annual tax gap that exists and that gap has continued to grow.[502] The tax gap is defined as the

[497] Robert W. Wood, *FBAR Penalties: When Will IRS Let You Off With A Warning?* Forbes, June 4th, 2012, *available at* https://www.forbes.com/sites/robertwood/2012/06/04/fbar-penalties-when-will-irs-let-you-off-with-a-warning/#6c87bec5363c; *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 373 (Palgrave MacMillan 2016); Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[498] Robert W. Wood, *FBAR Penalties: When Will IRS Let You Off With A Warning?* Forbes, June 4th, 2012, *available at* https://www.forbes.com/sites/robertwood/2012/06/04/fbar-penalties-when-will-irs-let-you-off-with-a-warning/#6c87bec5363c; *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 373 (Palgrave MacMillan 2016).
[499] Robert W. Wood, *FBAR Penalties: When Will IRS Let You Off With A Warning?* Forbes, June 4th, 2012, *available at* https://www.forbes.com/sites/robertwood/2012/06/04/fbar-penalties-when-will-irs-let-you-off-with-a-warning/#6c87bec5363c.
[500] Internal Revenue Manual, pt. 4.26.16.6 (11-06-2015); *See also*, Charles P. Rettig, *Why the Ongoing Problem with FBAR Compliance*, J. Tax & Proc. 37, 39 (August/September 2016).
[501] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-4 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119
[502] GAO, *Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance*, Report to the Committee on Finance, U.S. Senate, GAO-18-39, 3 (October 2017); *See also*, https://www.irs.gov/newsroom/the-tax-gap, Charles P. Rettig, *Why the Ongoing Problem with FBAR Compliance*, J. Tax & Proc. 37, 39 (August/September 2016).

difference between the tax liability that is due and the amount actually received by the IRS via the voluntary compliance of taxpayers.[503]

4.3.6.1 What Constitutes a Willful versus Non-Willful Violation?

Initially, it was thought that the IRS would apply the maximum penalty infrequently and only for extreme cases, such as with an account that could be linked to terrorist or criminal activity, and this line of thinking was bolstered by published IRS guidance. Despite this line of thinking, the IRS, as well as the Department of Justice (DOJ) who prosecute the cases, have taken a drastic stance on criminal and civil FBAR cases by seeking the maximum penalties.[504] One of the questions the civil cases turn on is whether or not the violation of the reporting requirement of the FBAR was willful. This section will explore what the courts say willful means, why the holdings of the majority of courts are flawed and how the term should be defined.

The BSA does not define willfulness with regard to civil or criminal penalties.[505] The question regarding FBAR penalties, then, is where is the definition of willfulness found? Since the legislation containing the law does not define willfulness, the next place to look for a definition is the courts and the courts have, in the context of tax law violations, defined what qualifies as willfulness.[506] Why is it important to define willfulness? As one scholar so artfully stated, it is because willfulness "is the trigger of the IRS gun that can fire a bullet capable of decimating a taxpayer's wealth."[507] Under the Constitution, the federal government cannot deprive the taxpayer of their

[503] I.R.S. News Release IR-2012-4 (Jan. 6, 2012), *found* at https://www.irs.gov/newsroom/irs-releases-new-tax-gap-estimates-compliance-rates-remain-statistically-unchanged-from-previous-study *See also,* J.T. Manhire, *What Does Voluntary Compliance Mean?: A Government Perspective*, 164 U. of Penn. L. Rev. 11 (2015).
[504] Martin R. Press and Nathan W. Hill, *FBAR PENALTIES and U.S. v. Zwerner*, 41 Int'l Tax J. 18 (January-February 2015).
[505] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 372 (Palgrave MacMillan 2016).
[506] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 373 (Palgrave MacMillan 2016).
[507] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 373 (Palgrave MacMillan 2016).

property without due process of law.[508] Thus, a taxpayer and the IRS need to have a guideline as to what constitutes a willful violation.

This is where the importance between a non-willful violation and a willful violation has an effect. The civil penalty statute, 26 U.S.C. §5231(a)(5) created a distinction between a non-willful and willful violation by providing for separate penalties in two different subsections.[509] §5231(a)(5)(A) - (B) is the statute addressing non-willful violations and the subsequent subsection §5231(a)(5)(C) addresses willful violations. Congress apparently wanted to make this distinction by only addressing the willfulness part of the statute instead of creating two subsections. This distinction is crucial because many of the cases do not seem to distinguish between non-willful and willful violations; they hold only to a strict liability reading of the statute.[510] There were no cases construing willfulness from a civil penalty standpoint until 2012, therefore, the cases that initially defined willfulness were from a criminal penalty viewpoint.[511]

Since 2012, there have been a few cases that define willfulness[512] and this is most likely due to the previous lack of enforcement.[513] However, the cases that do exist have generally held that willfulness turns on whether it was a voluntary, deliberate

[508] U.S. Const. amend. V
[509] Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 257 (Fall 2014).
[510] Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 256 (Fall 2014).
[511] IRS C.C.A. 200603026, 2006 WL 148700, at 1 (Jan 20, 2006); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251 (Fall 2014).
[512] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 373 (Palgrave MacMillan 2016).
[513] U.S. Dep't of the Treasury, *A Report to Congress In Accordance With §361(b) of the Uniting and Strengthening American by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (USA Patriot Act) 12 (April 26, 2002); See also, Bedrosian v. United States, 2017 WL 1361535 (E.D. Penn., April 13, 2017).

abuse of a known legal duty or a violation based on reckless conduct.[514] Multiple courts have affirmed that a voluntary, intentional violation of a known legal duty is considered willfulness.[515] In fact, in one case, *United States v. Williams*, which was upheld by another court in *United States v. McBride,* the *Williams* court held that essentially all a taxpayer has to do in order to willfully violate the FBAR reporting requirement is to sign the tax return which gives them constructive knowledge of the FBAR filing requirements.[516]

Despite the multiple courts that have held to the strict liability, at least one court has deviated from this holding. In *United States v. Flume,* the court declined to follow both *Williams* and *McBride* arguing that the constructive theory is unpersuasive.[517] One of the reasons that the court gives for this is that the holdings in *Williams* and *McBride* "*ignores the distinction Congress drew between willful and non-willful violations of §5314. If every taxpayer, merely by signing a tax return, is presumed to*

[514] *Cheek v. United States,* 498 US 192 (1991); *See also, United States v. Kelley-Hunter,* 281 F.Supp.3d 121, 124 (D.D.C. 2017); *United States v. Katwyk*, 2017 WL 6021420, 4 (C.D. Cal., Oct. 23, 2017); *United States v. Bohanec*, 263 F.Supp.3d 881 (C.D. Cal 2016); *United States v. Bussell*, 2015 WL 9957826 (C.D. Cal. Dec. 8, 2015); *United States v. Williams*, 489 Fed.Appx. 655 (4th Cir. 2012); *United States v. McBride*, 908 F.Supp.2d 1186 (D. Utah, 2012); *United States v. Garrity*, 304 F.Supp.3d 267 (D. Conn 2018); *United States v. Horowitz*, 2019 WL 265107 (D. Maryland, Jan. 18, 2019); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age,* 353, 373 (Palgrave MacMillan 2016).

[515] *Cheek v. United States*, 498 US 192 (1991); *See also, United States v. Kelley-Hunter,* 281 F.Supp.3d 121, 124 (D.D.C. 2017); *United States v. Katwyk*, 2017 WL 6021420, 4 (C.D. Cal., Oct. 23, 2017); *United States v. Bohanec*, 263 F.Supp.3d 881 (C.D. Cal 2016); *United States v. Bussell*, 2015 WL 9957826 (C.D. Cal. Dec. 8, 2015); *United States v. Williams*, 489 Fed.Appx. 655 (4th Cir. 2012); *United States v. McBride*, 908 F.Supp.2d 1186 (D. Utah, 2012); *United States v. Garrity*, 304 F.Supp.3d 267 (D. Conn 2018); *United States v. Horowitz*, 2019 WL 265107 (D. Maryland, Jan. 18, 2019).

[516] *United States v. Williams*, 489 Fed.Appx. 655 (4th Cir. 2012); *United States v. McBride*, 908 F.Supp.2d 1186 (D. Utah, 2012); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).

[517] *United States v. Flume*, 2018 WL 4378161 (S.D. Tex. Aug. 22, 2018).

know of the need to file an FBAR, "it is difficult to conceive how a violation could be non-willful"". [518]

Three Supreme Court cases are important to this discussion. The first case, *Cheek v. United States*, held that statutory willfulness is the voluntary, intentional violation of a known legal duty. The court also found that in order to prove willfulness the IRS has to prove *actual knowledge* of the legal duty owed, not just constructive knowledge.[519] Three years later the court in *Ratzlaff v. United States* held that in order to prove willfulness the government has to prove that the taxpayer acted with knowledge. "*Viewing…in light of the complex provisions in which they are embedded, it is significant that the omnibus "willfulness" requirement….has been read by the Court of Appeals to require both knowledge of the reporting requirement and a specific intent to commit the crime or to disobey the law*."[520] This is an important point because there is an argument that these first two cases were criminal FBAR cases and that these cases do not apply to FBAR civil penalty cases. However, the court in Ratzlaff states that the willfulness requirement "*must be construed the same way each time it is called into play."*[521] That means when a taxpayer - with actual knowledge and specific intent - violates the law the willfulness requirement will be applied equally in civil and criminal cases. Even in a Chief Counsel Advice memo from 2006, the IRS acknowledges that "*willfulness*" in a civil penalty case has the same definition and interpretation as in a criminal case.[522]

The last Supreme Court case that is important is the *Bryan* case which carved out an exception to the general rule that ignorance of the law is no excuse. The court said

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[518] *United States v. Flume*, 2018 WL 4378161 (S.D. Tex. Aug. 22, 2018); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[519] *Cheek v. United States*, 498 U.S. 192 (1991).
[520] *Ratzlaff v. U.S.*, 510 U.S. 135 (1994).
[521] *Ratzlaff v. U.S.*, 510 U.S. 135 (1994).
[522] IRS, C.C.A. 200603026, 2006 WL 148700 (January 20, 2006); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).

that cases like *Ratzlaff* involved statutes that were highly technical and "*presented the danger of ensnaring individuals engaged in apparently innocent conduct*." The exception, based on this reasoning, says that because of the highly technical nature of the law that the defendant is required to have knowledge of the law.[523] The FBAR, itself, is a piece of highly technical legislation and should be viewed as such.[524]

This evidence suggests that *Williams* and *McBride* are faulty law based on faulty logic that ignores relevant precedent as well as the distinction that Congress made in the statute itself between willful and non-willful.[525] It also ignores the fact that the FBAR is a highly technical law that not all taxpayers understand or are aware that they have an obligation to file.

Willful, based on the appropriate court precedent, the statute itself and the IRS' own admission (although this is not authoritative but merely persuasive), should be defined just as *Ratzlaff* defined it: it requires both knowledge of the reporting requirement and specific intent to commit the crime or disobey the law.[526]

However, it seems that the majority of courts are leaning towards the strict liability reading of the willfulness and will sweep even the most innocent of taxpayers into this spider web which does not help their goal: bringing taxpayers into compliance with the law and, as a result, through disclosure by the taxpayer procuring the information need to administer the tax laws correctly and fairly.

The court in *Ratzlaff* is correct. If the courts are to proceed with the strict liability reading of willfulness it is hard to imagine what taxpayer would not be considered to

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[523] *Bryan v. U.S*., 52 U.S. 184 (1998); See also, Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[524] Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[525]Kyle Niewoehner, *Feigning Willfulness: How Williams and McBride Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, Vol. 68 No. 1 Tax Lawyer 251, 252 (Fall 2014).
[526] *Ratzlaff v. U.S.*, 510 U.S. 135 (1994).

be willful. The cases that have leaned toward strict liability have been more recent than the former Supreme Court cases that were discussed above. If the Supreme Court was to take up this specific issue, the Court would most likely fall on the side of a less strict reading of willfulness. This is based on a couple of things. Congress purposely made a distinction in 26 U.S.C. §7201 when it focused completely on willfulness. The Supreme Court generally does not ignore what Congress intended unless it is unconstitutional. There is no argument that Congress acted unconstitutionally. Another reason the Court would hold for a less strict reading of willfulness is based on their prior holdings in *Cheek, Ratzlaff and Bryan.* The court itself has said under those cases that willfulness under the statute is the voluntary intentional violation of a *known* legal duty and that it takes actual knowledge of the legal duty. It should also be argued that with this highly technical piece of law that taxpayers should be held to a reasonably prudent lawyer/businessperson standard since those are the persons most likely to understand the law and all its technicalities. If this standard held, everyday Joe taxpayer would not fall under the willfulness standard since many taxpayers are unaware that they fall under the requirements.

4.4. FBAR: CONCLUSION

The Report of Foreign Bank and Financial Accounts (FBAR) is an anti-tax evasion measure that the IRS uses to obtain information on U.S. taxpayers' foreign accounts. The FBAR requires that the taxpayer file annually a report that declares that they hold an interest in a foreign financial account.

The FBAR is far from qualifying as a successful measure that obtains taxpayer information on their foreign accounts. The compliance numbers alone demonstrate that the FBAR, as a stand-alone measure, does not fully address the problem stated in this thesis – the inability of the U.S. government to obtain information on U.S. taxpayers' foreign accounts. The 2011 estimate that only 741,000 U.S. taxpayers out of millions of U.S. taxpayers (both resident and non-resident) filed an FBAR

establishes that this measure alone is inadequate to fulfill the IRS' goal of receiving information on the foreign accounts so that they can administer the tax laws fairly and correctly. The FBAR filings, according to the IRS and FinCEN, increased 17% per year from 2012-2016 yet the tax gap remains[527] and that number is still only a couple million taxpayers.

The elements clarify who should file an FBAR – a U.S. person who has a financial interest in (or signatory authority over) a foreign financial account of which the aggregate value exceeds – at any time during the calendar year - $10,000.

The IRS walks a fine line (or should) in applying penalties to U.S. taxpayers who are truly evading taxes while not crucifying those taxpayers who fall under the reasonable cause exception and those who may not know of their filing obligations. Applying harsh penalties to an expat who moved to a foreign country to be reunited with a spouse, for example, and who may not be aware of their filing obligations under the FBAR seems to be overkill. The whole purpose of the FBAR penalties is to promote compliance with FBAR reporting requirements but how can one comply if they are unaware of the filing obligations?

On the other hand, U.S. taxpayers who are choosing to evade their filing obligations and paying their tax liability should be dealt with harshly. The penalties for willful violations, in this author's opinion, are not enough. The Panama Papers and the Paradise Papers referred to in the introduction of this thesis demonstrate that tax evasion is popular among the wealthy, elite and powerful. The penalties, highlighted by these examples, demonstrate that wealthy taxpayers are willing to risk discovery of tax evasion and pay the penalties laid out.

The FBAR's downfall is that the U.S. government is hoping that the taxpayer will voluntarily comply and report their foreign accounts. While the FBAR has worked to

[527] Charles P. Rettig, *Why the Ongoing Problem with FBAR Compliance*, J. Tax & Proc. 37, 38 (August/September 2016); *See also*, https://www.irs.gov/newsroom/foreign-account-filings-top-1-million-taxpayers-need-to-know-their-filing-requirements

encourage some to self-report, it is not encouraging all the taxpayers – or even a considerable number of taxpayers - who have accounts abroad to comply. Another part of the disconnect that seems to occur is that the IRS and DOJ are pursuing taxpayers under the broader definition of willfulness which is penalizing some of the taxpayers that are making innocent mistakes or had no knowledge of the reporting requirement. This strategy seems to still miss the group that is truly the target and that is the taxpayers who deliberately evade their tax obligations.

To target the U.S. taxpayers that may not be aware of the FBAR filing obligations or for those who make innocent when filing a couple of suggestions could be done to ensure compliance with the FBAR – all without threatening penalties for those types of cases. The case and surrounding facts usually establish whether a taxpayer has made an innocent mistake (reasonable exception) or does not know of the filing requirements versus a taxpayer who is purposely, willfully evading their obligations.

The first suggestion is to partner up with the Department of State (State Department) and send out emails at tax time to remind U.S. taxpayers in their country of their filing obligations for tax returns, FBAR filings and any Foreign Account Tax Compliance Act (FATCA) obligations they may have while reminding them these obligations may not be the only obligations they fall under and to seek advice from a tax professional. At the end of the email the State Department can link to the IRS website where guidance is given to those taxpayers that have interest in foreign financial accounts.

A second suggestion would be for the IRS to wage an educational campaign that is targeted specifically for U.S. taxpayers who have foreign financial accounts. This education campaign can include hosting an IRS blog, Twitter account or YouTube channel specifically for these types of taxpayers so that when they are looking for guidance these social media accounts would pop up in the search. However, if incorrect guidance is given on an official IRS social media account the taxpayer should be held liable for that mistake unless it can be proven that they did not act on that advice but instead acted upon some other basis.

To target the U.S. taxpayers whose choice is to willfully evade taxes, then the suggestion would be to increase the stick portion of the carrot-stick scenario. For civil penalties when it has been a willful violation, increase the current $100,000 or 50% of the highest balance in the U.S. taxpayers foreign account for each violation amount to $500,000 or 60% of the highest balance for each violation and for each year. For the criminal penalties, those should be increased significantly as well to $750,000 and 10 years of imprisonment. For those violations within a pattern of illegal activity, those penalties should be increased to $1,000,000 and up to 20 years of imprisonment. The justification for the increases in the penalties is found in the continued behavior of tax evader as demonstrated through the release of the Panama and Paradise papers as well as the low-compliance rates of the FBAR. Another justification for increasing the penalties is that those that can afford to weigh the risk and proactively choose to evade their obligations are usually the taxpayers that can afford the penalties because as they stand now the penalties are inconsequential.

Again, those penalties should not be enforced against those that make innocent mistakes and can qualify for the reasonable cause exception or those who can demonstrate that they truly did not know about their filing obligations. The facts and circumstances should be construed in favor of the taxpayer if they do not fall within a professional realm that would have cause to know or should know about the obligations – for example, lawyers, business-savvy taxpayers or tax professionals.

The FBAR as a stand-alone measure is generally only netting those that come forward voluntarily or on occasion the taxpayers they catch evading and, therefore, the IRS is not obtaining the information they need to administer the tax laws fairly and correctly. However, as said above, the taxpayers and accounts they really want are those that are truly, under the *Ratzlaff* definition of willfulness, evading their tax reporting and payment obligation. As part of the framework of anti-tax evasion measures and with an increase in penalties, the FBAR could be a stronger compliance tool. This would allow the IRS to fulfill the goal of procuring taxpayer information on foreign accounts.

In the next chapter, the next IRS measure – voluntary disclosure programs – that is used to try to procure information on U.S. taxpayers' foreign accounts is also dependent on the taxpayer's voluntary compliance. The question for the next chapter is do the voluntary disclosure programs, when implemented, address the inability to procure U.S. taxpayers' information on foreign accounts so that the IRS can administer the tax laws fairly and correctly?

CHAPTER 5. VOLUNTARY DISCLOSURE PROGRAMS

5.1. INTRODUCTION

In the previous chapter, the Report of Foreign Bank and Financial Accounts (FBAR) is dependent upon the voluntary compliance of the taxpayer fulfilling their reporting requirements on their foreign accounts. The result is that the Internal Revenue Service (IRS) is only able to obtain information on accounts abroad on those taxpayers that voluntarily comply with the FBAR filing requirements and, occasionally, those they "catch" concealing.

Another measure that the IRS and Department of Treasury use in their multi-prong effort to procure taxpayer information on foreign accounts that is also dependent on taxpayer compliance is the utilization of voluntary disclosure programs. These programs are inextricably linked with the previous measure, the FBAR, since the programs required the taxpayer to file past FBARs and pay FBAR penalties.

This chapter will discuss the multiple voluntary disclosure programs that the IRS offered to coerce taxpayers into disclosing their accounts abroad. The chapter then analyzes how the voluntary disclosures are implemented so that they help the IRS obtain the taxpayers information on their foreign accounts. The last section will focus on whether the voluntary disclosure programs, when administered, enable the IRS to procure the information needed on the taxpayers' foreign accounts so that they have the whole picture (facts) to apply the tax laws fairly and correctly. If the voluntary disclosure programs do not permit the U.S. government to procure the information they need on U.S. taxpayers' foreign accounts, how can the voluntary disclosure programs be improved upon so that it increases the chances of obtaining the information needed?

5.2. IMPLEMENTATION OF THE PROGRAMS

The IRS, in order to capture some of the missing tax revenue from abroad and obtain taxpayer information on their foreign accounts, has offered multiple, consecutive programs called Offshore Voluntary Disclosure Programs (OVDP). The purpose of these multiple tax amnesty programs was to bring taxpayers who concealed their money offshore through various means — including offshore payment cards — back into compliance with the law.[528] The proffered tax amnesty programs allowed certain taxpayers who came forward voluntarily to avoid civil penalties as well as criminal prosecution while still having to pay back taxes, interest and certain types of penalties.[529] This also allowed the IRS to gather information on not just the taxpayers — whose requirements will be discussed below — and their accounts but also the offshore promoters that solicited taxpayer business through offshore programs.[530] Amnesty programs are also a cost-effective way for the IRS to recover some of the money lost to offshore jurisdictions.[531] Despite the friendliness of the term "amnesty" that the IRS uses in offering these programs, Stephan Michael Brown alleges that this

[528] IRS, *IRS Unveils Offshore Vountary Compliance Initiative, found at* https://www.irs.gov/newsroom/irs-unveils-offshore-voluntary-compliance-initiative-chance-for-credit-card-abusers-to-clear-up-their-tax-liabilities; *See also,* IRS, *Offshore Compliance Program Shows Strong Results, found at* https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results; *Offshore Voluntary Disclosure Program Ending in September*, 128 J. Tax'n 4 (May 2018); Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 676 (2018).

[529] IRS, *IRS Unveils Offshore Voluntary Compliance Initiative, found at* https://www.irs.gov/newsroom/irs-unveils-offshore-voluntary-compliance-initiative-chance-for-credit-card-abusers-to-clear-up-their-tax-liabilities; *See also,* Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655 (2018).

[530] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 2 (March 2009; See also, Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655 (2018).

[531] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons With the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 290 (Spring 2013); See also, Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655 (2018).

offer of amnesty is actually a false offer of amnesty.[532] Amnesty means, as defined by Black's Law, a pardon extended by the government to a group or class of persons.[533] The allegation of false amnesty is a bit severe. While taxpayers who are admitted to these disclosure programs do not have their slates wiped completely clean, the penalties and consequences are not nearly as severe as they could (or should) be if the taxpayer did not voluntarily disclose and the IRS discovered the noncompliance on its own. The taxpayer still must pay penalties and can potentially face other consequences so the term "*quasi-amnesty*" is more appropriate. These programs are discussed more in depth in the following sections and how they are administered so that they IRS can hopefully procure information on U.S. taxpayers' foreign accounts.

5.2.1. OPERATION OF THE PROGRAMS

At the beginning of 2003, the IRS offered an extremely limited, three-month program called the Offshore Voluntary Compliance Initiative which is also known as the OVCI[534]. This program targeted those taxpayers who utilized offshore payment cards to hide income and assets offshore.[535] Through this program the IRS was able to

[532] Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243 (2014).
[533] Black's Law Dictionary, 7th edition (Editor Bryan A. Garner 1999).
[534] Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783 (August 6, 2018); See also, Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017); GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 2 (March 2009); https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results
[535] https://www.irs.gov/newsroom/irs-unveils-offshore-voluntary-compliance-initiative-chance-for-credit-card-abusers-to-clear-up-their-tax-liabilities; https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results; *See also*, Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783 (August 6, 2018); *See also*, Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017).

collect approximately $75 million from roughly 1300 individuals[536] who came forward and identified themselves to the IRS. However, a year later, the Government Accountability Office (hereinafter GAO) reported that the program had 861 taxpayers use the program while this round of voluntary disclosures collected $200 million in unpaid taxes, penalties and interest. There is no reason given for the discrepancy in numbers. The IRS, in a 2003 press release, stated that they had drawn in $75 million with 1,299 taxpayers applying but that they were still processing applications. If most applicants were subsequently processed, that would explain the increase to $200 million in collected back taxes and penalties, however it does not explain the decrease in the number of applicants. Based on the IRS press release as well as other articles that give the $75 million paid by roughly 1300 taxpayers figure, this thesis will assume these two figures are correct.

During the OVCI, four hundred offshore promoters were identified as well during this time through the information received by the taxpayers.[537] The IRS defines an offshore promoter as a "*person or entity who markets offshore arrangements to the public.*"[538] These promoters can be anything from a financial institution to a lawyer to an accountant.[539]

While some touted this program as a success, the $75 million tag is not remotely close to the prior alleged $100 billion a year estimation of tax revenue – which has been called "*unsubstantiated"* by at least one set of scholars – that has been lost to offshore

[536] IRS, *Offshore Compliance Program Shows Strong Results, found at* https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results ; *See also,* John Paul, *The Future of FATCA: Concerns and Issues*, 37 N. E. J. Legal Stud. 52 (Spring/Fall 2018*)*; Noam Noked, *The Future of Voluntary Disclosure,* 160 Tax Notes 783 (August 6, 2018); *See also,* Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017);
[537] IRS, *Offshore Compliance Program Shows Strong Results, found at* https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results; *See also*¸ https://www.irs.gov/newsroom/irs-unveils-offshore-voluntary-compliance-initiative-chance-for-credit-card-abusers-to-clear-up-their-tax-liabilities;
[538] IRS, *Glossary of Offshore Terms*, https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-glossary-of-offshore-terms
[539] IRS, *Glossary of Offshore Terms*, https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-glossary-of-offshore-terms

tax evasion[540] which means this program, while bringing some of the tax evaders to light, was not entirely successful.[541] One reason for this might be that not all of the "*tax evaders*" were intentional tax evaders and, therefore, these programs are utilized by those taxpayers that mistakenly or unknowingly evaded taxes.[542] The IRS, in a news release discussing the success of the program, noted that this program was part of a multi-pronged effort to track down tax evaders.[543] This multi-pronged effort – or what Richard A. Gordon referred to in his 1981 report as a "*coordinated federal attack*"[544] – includes not only multiple disclosure programs that followed but also the anti-tax evasion measures identified in this thesis.

The next voluntary disclosure program did not occur until 2009. This longer-term voluntary disclosure program ran from March 26, 2009 through October 15, 2009.[545] The second program was conducted from February 8, 2011 through September 9, 2011 and peaked at 18,000 taxpayers who disclosed.[546] The third and final disclosure

[540] U.S. Senate Permanent Subcomittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-4 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119; James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 985 (2016-2017).
[541] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 291-292 (Spring 2013).
[542] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 2 (March 2009.)
[543] IRS, *Offshore Compliance Program Shows Strong Results, found at* https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results
[544] Richard A. Gordon, Special Counsel for International Taxation, *Tax Havens and Their Use by United States Taxpayers – An Overview*, Department of the Treasury, Publication No. 1150 (4-81)(1981).
[545] Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783, 784 (August 6, 2018); See also, Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade*?, 151 J. Pub. Econ. 110 (2017); Travis A. Greaves & T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 208 (July 13, 2015); See also, Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 676 (2018).
[546] *Offshore Voluntary Disclosure Program Ending in September*, 128 J. Tax'n 4 (May 2018); *See also,* Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783, 784 (August 6, 2018); *See also,* Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017); *See also,* Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 676-677 (2018).

program started in January of 2012. This disclosure program had some modifications which then became known as the 2014 OVDP.[547] The third program was an open-ended program which ended in September 2018 after the number of participants declined in 2017 resulting in only 600 disclosures.[548] The IRS reported that since the first voluntary disclosure program was instituted more than 56,000 taxpayers have utilized the disclosure programs and a total of 11.1 billion USD in back taxes, interest and penalties was collected.[549]

The third voluntary disclosure program was offered due to the high level of interest in the prior programs.[550] These voluntary compliance programs - by June of 2012 - had 33,000 U.S. taxpayers who voluntarily disclosed their foreign assets which resulted in the government collecting more than $5 billion. Despite the fact that thousands of U.S. taxpayers utilized these programs to "come clean", this is only a trivial amount compared to the estimated $100 billion USD in lost tax revenue that is

[547] Offshore Voluntary Disclosure Program Ending in September, 128 J. Tax'n 4 (May 2018); *See also,* IRS, *IRS to End Offshore Voluntary Disclosure Program, found at* https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now; *See also,* https://www.irs.gov/newsroom/2012-offshore-voluntary-disclosure-program; Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 676-677 (2018).

[548] IR-2018-52 (March 13, 2018), *found at https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now; See also*, Noam Noked, *The Future of Voluntary Disclosure,* 160 Tax Notes 783, 784 (August 6, 2018); *See also*, Dominika Lagenmayr, *Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?*, 151 J. Pub. Econ. 110 (2017);

[549] *Offshore Voluntary Disclosure Program Ending in September*, 128 J. Tax'n 4 (May 2018); *See also*, IR-2018-52 (March 13, 2018), *found at*, https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now ; *See also*, Jeffery D. Moss, *Foreign Bank Account Reports: Will There Be More Scrutiny of FBARS and Other Disclosure Returns*, 31 Foreign Bank Account Reports 29, 31 (Spring 2018); Noam Noked, *The Future of Voluntary Disclosure,* 160 Tax Notes 783, 784 (August 6, 2018).

[550] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 760 (2014); *See also*, https://www.irs.gov/newsroom/2012-offshore-voluntary-disclosure-program

held offshore.[551] As Sean Deneault notes, these citizens have had multiple chances to bring their accounts into compliance and they continue to choose not to. The question is why? He posits that the reason so many leave their assets offshore is not due to ignorance but because it makes financial sense.[552] He argues that they have examined their situations and decided that non-compliance is worth the risk of the U.S. government finding out and applying penalties.[553] This is a reasonable assumption to make in light of the release of the Panama and Paradise papers. It is also possible that some of these citizens just simply do not want to pay taxes despite the fact that paying taxes is an obligation of being a U.S. citizen notwithstanding if the taxpayer thinks the taxes are unreasonable or not.

A 2009 report by the GAO found that the taxpayers that utilized the voluntary disclosure programs were of a diverse group of incomes and occupations and based on this data, the IRS created a database that tracked taxpayer information such as income, use of promoters and taxes owed.[554] They also found that there was a wide range of intention among the taxpayers that ranged from deliberate non-compliance with reporting to the unintentional.[555] However, as pointed out in the report, it is important to keep in mind that these characteristics and data are from a small group of taxpayers that participated in the OVCI and does not account for the larger group

[551] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014); See also, Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 291-292 (Spring 2013); Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243 (2014).
[552] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014).
[553] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014).
[554]GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 2 (March 2009.
[555] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 3 (March 2009.

of taxpayers that did not take part and may be illegally concealing their money offshore.[556]

The report noted that a majority of the taxpayers that chose to use the OVCI had, in fact, filed a tax return reporting their income as well as paying the taxes due but failed to file an FBAR.[557] That could be simply because those taxpayers were part of the group of taxpayers that did not realize they had an obligation to file the FBAR. While the non-filers in this report were a small minority, they did not file a tax return nor did they file an FBAR because, according to an IRS official, they were illegally evading taxes and hiding their assets offshore.[558] This report's findings is more evidence that those that use voluntary disclosure programs want to voluntarily comply and are not the taxpayers who choose to conceal foreign accounts and continue to decide that non-compliance is worth the risk.

The diversity of professions that were identified in the report were taxpayers that worked and those that were retired.[559] Of those that worked, the professions ranged from executives to medical professionals to building trades.[560] While the retired applicants accounted for the most applications, the professions that applied for the OVCI the most were the executives, business/self-employed individuals and the professionals involved in the banking, financial and insurance industries (which were grouped together).[561] These are the taxpayers that would be considered professionals that are legally, financially and business savvy. They would more than likely be aware

[556] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 3 (March 2009.
[557] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 56 (March 2009.
[558] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 56 (March 2009.
[559] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 62 (March 2009.
[560] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 62 (March 2009.
[561] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 62 (March 2009.

of their tax filing obligation as opposed to those not employed in the business, legal or financial world.

Another piece of data that the IRS tracked was the geographical location of the OVCI applicant by tax year.[562] According to the tables provided in the report, Florida always had the largest number of applicants and half of all applicants were to be found (at least for the years represented in the report) in Florida, California, Connecticut, Texas and New York.[563] Interestingly, U.S. taxpayers that were living outside of the U.S. are not mentioned.

5.2.1.1 What Do the Disclosure Programs Require?

The compliance programs, while being offered over multiple years, have several characteristics in common.[564] All of the programs required the taxpayer to pay back taxes and interest owed for a certain number of years in order to avoid criminal prosecution along with paying an offshore penalty and a delinquency/accuracy penalty.[565] Filing amended or late FBARs which includes identifying the taxpayer's foreign bank accounts is also required when a taxpayer participated in one of the disclosure programs.

The Internal Revenue Manual (hereinafter IRM) is a procedural guide for IRS agents and it covers everything from criminal tax to taxpayer education and assistance to organization and finance and management. The part of the manual that is of interest to this chapter is Part 9, Criminal Investigation, Chapter 5 Investigative Process and Section 11, Other Investigations. Under this section, there is a subsection for Voluntary Disclosure Practice. This section discusses how the voluntary disclosures should be managed and how to evaluate and transmit the disclosure.[566] This part of

[562] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 58 (March 2009.
[563] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 58 (March 2009.
[564] Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 677 (2018).
[565] Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 677 (2018).
[566] Internal Revenue Manual, 9.5.11.9.1 – 9.5.11.9.10

the manual is the roadmap for what the taxpayer must do to file a voluntary disclosure that the IRS will accept.

An acceptable voluntary disclosure happens when the information is truthful, timely, complete and when the taxpayer fulfills two requirements: 1) the taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his/her correct tax liability and 2) the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest and any penalties determined by the IRS to be applicable.[567] In order to be considered a timely disclosure the taxpayer has to submit the disclosure to the IRS before the IRS has either initiated a civil or criminal investigation of the taxpayer, received information from a third party regarding the taxpayer's noncompliance or received information from a criminal enforcement action such as a search warrant.[568] The IRM makes it clear that a voluntary disclosure does not guarantee automatic immunity from prosecution and that the voluntary disclosure is considered with all other relevant factors.[569] Taxpayers cannot rely on the fact that other taxpayers are similarly situated in the hopes of avoiding criminal prosecution but filing a voluntary disclosure may result in the IRS not recommending prosecution.[570] If the case involves illegal source income, then the practice of voluntary disclosure and the potential immunity from prosecution does not apply.[571]

The voluntary disclosure can take any form as long as it meets elements of subsection 9.5.11.9. This means that a letter from an attorney that includes amended returns that are correct and truthful, which offers to pay the tax, interest and any penalties due and which has also been done in a timely manner is acceptable considering it meets the elements listed in the paragraph.[572] The IRM gives several examples of what qualifies

[567] Internal Revenue Manual, 9.5.11.9(3).
[568] Internal Revenue Manual, 9.5.11.9(4).
[569] Internal Revenue Manual, 9.5.11.9(1)-(2); *See also*, Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783, 784 (August 6, 2018).

[570] Internal Revenue Manual, 9.5.11.9(1)-(2); *See also*, Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783, 784 (August 6, 2018).
[571] Internal Revenue Manual, 9.5.11.9(2).
[572] Internal Revenue Manual, 9.5.11.9(5).

as a voluntary disclosure and what does not.[573] The IRM notes that the question of whether a communication by the taxpayer qualifies as a voluntary disclosure is determined only by an examination of the facts and circumstances of each investigation.[574]

After the taxpayer has gone through the process of voluntarily disclosing, the IRS can assess penalties and fines in relation to both late returns and applicable FBARs.

5.2.2. PENALTIES

The IRS has a penalty structure as part of the disclosure programs, similar to the FBAR, to strongly encourage tax compliance through voluntary disclosure. The IRS uses a penalty scheme although the penalties are not as severe as the FBAR. The IRS claims that the benefits to the taxpayer(s) includes, but are not necessarily limited to, being in compliance with the tax laws, avoiding potentially sizeable civil penalties which also, in turn, eliminates prosecution.[575] It also provides the taxpayer a relative degree of certainty to the amount of penalties that they would owe.[576]

What penalties do taxpayers face regarding the voluntary disclosure programs? Are they effective or does the potential of penalties discourage taxpayers from entering into the disclosure programs and consequently prohibit the IRS from obtaining the information they seek?

The financial penalty that resulted from the OVDP program was originally set at 20% of the taxpayer's highest aggregate value of foreign accounts and assets during the

[573] Internal Revenue Manual, 9.5.11.9(6)-(7); *See also*, Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783, 784 (August 6, 2018).
[574] Internal Revenue Manual, 9.5.11.9.1(2)
[575] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016);
[576] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016); *See also*, IRS, *2012 Offshore Voluntary Disclosure Program*, https://www.irs.gov/newsroom/2012-offshore-voluntary-disclosure-program

examined years for the first compliance program in 2009.[577] Over the subsequent years of the programs, the penalty increased until the last program — which ended in September 2018 — was set at 27.5%.[578] However, reduced penalties can be applied in certain situations – for example, a taxpayer who is unaware they are a U.S. citizen – for taxpayers who qualify for it.[579] An illustration of this would be a child born in Denmark who is born to an American parent who conveys American citizenship to the child just because that parent is a citizen of the United States, and a parent of another nationality. That child spends their life in Denmark and never steps foot in the U.S. probably would not realize they are a United States citizen. Another example would be a child born to foreign-born parents who are working in the United States on a visa and who are residents in the states short-term (few months to a few years). The child then spends the rest of their life living in the home country of their parents. While the parents are not citizens of the United States, the child is an automatic citizen as a result of being born in the America.

In order to be accepted into the voluntary disclosure programs, the taxpayer has to agree to pay an FBAR penalty as part of the deal even if the taxpayer had no prior knowledge of his duty to file FBAR or if the taxpayer qualifies for a waiver of penalties based on the reasonable cause exception.[580] This, D.S. Kerzner and D.W. Chodikoff argue, allows the IRS to impose the willfulness penalty on taxpayers without meeting the obligation of proving that the individual taxpayer's actions were willful.[581] The problem, from this viewpoint which is correct, is that the taxpayer who

[577] Jeffery D. Moss, *Foreign Bank Account Reports: Will There Be More Scrutiny of FBARS and Other Disclosure Returns*, 31 Foreign Bank Account Reports 29, 31 (Spring 2018); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 380 (Palgrave MacMillan 2016);
[578] Jeffery D. Moss, *Foreign Bank Account Reports: Will There Be More Scrutiny of FBARS and Other Disclosure Returns*, 31 Foreign Bank Account Reports 29, 31 (Spring 2018); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 380 (Palgrave MacMillan 2016);
[579] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016).
[580] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016).
[581] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016).

makes an innocent mistake and who would most likely be covered under the reasonable exception clause under §5321(a)(5)(B)(i) is not covered from this under the voluntary disclosure programs.[582] The taxpayer was required as part of these programs to pay the FBAR penalty which under the last OVDP in 2009 was 20% of the amount in foreign accounts with the highest aggregate balance during the calendar year.[583] The innocent taxpayer who could under the FBAR penalty scheme raise the reasonable exception defense and avoid any penalty, now instead has to pay a fairly substantial FBAR penalty. "*The irony is that……in reality the IRS has thrown grandma and grandpa from the train by subjecting them to the costly professional fees related to entering a program and to its potentially eviscerating penalty structure when there would otherwise be no basis for the IRS to assess and collect these FBAR penalties."*[584] In 2014, the IRS modified the terms to the third OVDP and stated that taxpayers that did not act willfully might be able to qualify for a reduced penalty of 5% as well as only having to amend three years of tax returns instead of the eight that was required before.[585]

5.3. ALTERNATIVES?

What happens if the taxpayer does not want to enter into a voluntary disclosure program? Are there alternatives to voluntary disclosures that a taxpayer could pursue?

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[582] Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 Chapman L. Rev. 243, 252 (2014); See also, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 382 (Palgrave MacMillan 2016).
[583] Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance,* 18 Chapman L. Rev. 243 (2014).
[584] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age,* 353, 383 (Palgrave MacMillan 2016).
[585] Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance,* 18 Chapman L. Rev. 243 (2014).

Quiet disclosures and streamlined compliance are alternatives to voluntary disclosure programs and are discussed in the next two sections.

5.3.1. QUIET DISCLOSURES

A pure quiet disclosure occurs when a taxpayer amends a tax return to disclose offshore income and files past-due FBARS without addressing it directly with the IRS.[586] The quiet disclosures have become popular due to the disclosure programs.[587] This is in opposition to a "*manual disclosure*" which is a disclosure that occurs when a taxpayer has their tax advisor send the IRS a letter that explains the situation along with amended returns and other applicable forms with the end goal being the finalization of the returns and no criminal prosecution.[588] The IRS approves of this method of disclosure because it follows the procedures laid out in the IRM and these procedures may not lead to criminal prosecution.[589]

Quiet amendments drew little attention before 2008 and, when discovered, rarely drew harsh penalties from the IRS.[590] This allowed those that truly abused the system (and those to which the system is really after) to not fear the possibility of civil and criminal penalties for the failure to disclose.[591] The 2007 UBS case, once again, was the turning point for quiet disclosures as it was for the other initiatives such as FBAR and

[586] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207-208 (July 13, 2015); *See also*, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised; https://www.forbes.com/sites/robertwood/2011/04/13/quiet-foreign-account-disclosure-not-enough/#7fadb20c6649; https://www.forbes.com/sites/janetnovack/2011/02/08/irs-offers-new-amnesty-for-offshore-tax-cheats/#71a37677412b
[587] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207 (July 13, 2015).
[588] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207-208 (July 13, 2015).
[589] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207-208 (July 13, 2015);
[590] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 208 (July 13, 2015).
[591] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 208 (July 13, 2015).

the John Doe summons (subsequent chapter) because the U.S. government started using multiple avenues to procure taxpayer information on foreign accounts which then forced taxpayers into the position of needing to disclose their assets before they were discovered.[592]

A quiet disclosure is strongly disliked by the IRS as an approach to disclosing offshore assets and it does not consider a quiet disclosure a disclosure at all because taxpayers would normally be subject to penalties under the formal programs. If they use a quiet disclosure they sidestep these penalties and it is not detected before the statute of limitations runs out.[593] While utilizing one of the OVDPs protects a taxpayer from criminal prosecutions, filing a quiet disclosure does not provide the same protections which means the taxpayer opens themselves up to both criminal and civil prosecution as well as all penalties that would apply.[594] However, if a quiet disclosure does, in fact, go unnoticed the taxpayer could pay no penalties.[595] The taxpayer then has to decide whether the risk of choosing the quite disclosure route and possibly being detected by the IRS is worth it.

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[592]Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 208 (July 13, 2015).
[593]Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 210 (July 13, 2015); *See also*, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised; Forbes, *Quiet Foreign Account Disclosure Not Enough*, https://www.forbes.com/sites/robertwood/2011/04/13/quiet-foreign-account-disclosure-not-enough/#7fadb20c6649; Shu-Yi Oei, *The Offshore Tax Enforcement Dragnet*, 67 Emory L.J. 655, 676 (2018); Noam Noked, *The Future of Voluntary Disclosure*, 160 Tax Notes 783 (August 6, 2018).
[594] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 210 (July 13, 2015); *See also*, IRS, Offshore Voluntary Disclosure Program FAQs, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised
[595] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 210 (July 13, 2015).

5.3.2. STREAMLINED COMPLIANCE

The other alternative to the disclosure programs that a taxpayer can choose to use is the Streamlined Filing Compliance Procedures. The purpose of this program is "*to provide taxpayers who are able to certify that their failure to report foreign assets and pay all tax due in respect of those assets did not result from willful conduct on their part*."[596] These procedures require several steps that the taxpayer has to navigate. The taxpayer must certify that the failure to file was non-willful, file three years of tax returns and six years of FBARs.[597] There is a difference in penalties for this program depending on whether or not the taxpayer is a resident.[598] If the taxpayer is not a resident, then there are no penalties that result unless the "*examination determines that the original non-compliance was fraudulent and/or the FBAR violation was willful*."[599] This may be because a non-resident may not be familiar with the tax laws and requirements of the U.S. so unless they met the fraudulent or willful bar, no penalty would be assessed. However, if they are a resident taxpayer (which includes U.S. citizens abroad) then the penalty ceiling is 5% of the foreign financial assets.[600]

The streamlined procedures provide no protection from criminal prosecutions or IRS audits and once a taxpayer submits documents under the streamlined compliance program, the taxpayer cannot participate in the other voluntary disclosure programs.[601] The streamline compliance program has had 65,000 taxpayers utilize it in order to

[596] D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 386 (Palgrave MacMillan 2016).
[597] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 209 (July 13, 2015);
[598] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 209 (July 13, 2015);
[599] IRS, *U.S. Taxpayers Residing Outside the United States*, https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-outside-the-united-states
[600] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 209 (July 13, 2015).
[601] Travis A. Greaves and T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 Tax Notes 207, 209 (July 13, 2015); *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 353, 386 (Palgrave MacMillan 2016).

come into compliance with U.S. tax law[602]— still a very small number compared to the estimated 9 million U.S. taxpayers living abroad and the potentially millions of non-resident taxpayers.[603]

5.4. VOLUNTARY DISCLOSURES: CONCLUSION

The voluntary disclosure programs are another measure that the IRS uses in the hopes that they can obtain information on U.S. taxpayers' foreign accounts so that they can apply the facts correctly and fairly. The purpose of the voluntary disclosure programs was to get the taxpayers to disclose their foreign accounts and pay the taxes owed.[604] To do this the IRS outlined the procedures for disclosing and the potential penalties faced as discussed above. The voluntary disclosure programs were an opportunity that the IRS gave to the taxpayer –with some strong incentive in the form of penalties – to voluntarily disclose their foreign financial accounts.

The question then is whether the programs, as implemented, allow the U.S. government to procure formerly inaccessible taxpayer information on foreign accounts so that the IRS can then correctly and fairly administer U.S. tax law?

The answer to that question is partially no. The voluntary disclosure programs had very minor wins but not enough to really assert that these programs work overall. When a taxpayer voluntarily discloses, the disclosure fulfills two important goals the IRS has. First, it brings the taxpayer into compliance with tax laws. Second, the disclosure gives the IRS access to that taxpayer's information on their foreign

[602] IRS, *IRS to End Offshore Voluntary Disclosure Program,* https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now
[603] Americans Abroad, *How We Are Counted,* https://www.americansabroad.org/how-are-we-counted/
[604] IRS, *Statement of IRS Commissioner John Koskinen,* https://www.irs.gov/newsroom/statement-of-irs-commissioner-john-koskinen

accounts which allows the IRS to administer the tax laws fairly and correctly. It also can help the IRS discover potential facilitators and financial institutions that are helping Americans evade their taxes by obscuring any information that identifies the accounts as being held by Americans.

The programs work partially in that they do get some taxpayers to voluntarily disclose but not enough to say that the program is a total success and that it allows the IRS to obtain the information needed on foreign accounts of a large amount of taxpayers.

While the voluntary disclosure programs have encouraged some taxpayers to come back into compliance with the law, the real target, intentional tax evaders, generally remain non-compliant and will continue to do so if the risk to evade outweighs the potential consequences.[605] The 2009 GAO report discussed in subsection 5.2.1 supports this since the report results demonstrate that a majority of the taxpayers that chose to use the OVCI filed a tax return that reported their income and paid taxes. Tax evaders do not generally take those actions but if they do, they are generally fraudulent actions in that they do not include all of their income, they do not declare foreign accounts or pay the taxes they owe. Despite the small group of taxpayers that was evaluated in the report, the results can most likely be extrapolated to the other disclosure programs and their results.

The voluntary nature of the programs coupled with penalties that do not encourage taxpayers to comply is where the breakdown of this program occurs. As noted earlier in this chapter, many of the taxpayers have examined their situations and have chosen to risk non-compliance and the potential penalties that accompany that noncompliance. While the IRS had increased the penalties over the course of the various disclosure programs, the penalties are obviously not extreme enough to

[605] Alfred Bender, *Domination and Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 291 (Spring 2013).

warrant more taxpayers choosing compliance over the risk of being detected and the potential penalties that come with detection.

As one scholar says, the carrot and stick method of amnesty "*will only be successful if tax evaders believe that the IRS really has the stick to back up its talk, which seems increasingly less likely*."[606] The penalties of both the FBAR program and the voluntary disclosure programs have not seemed to be the stick that the taxpayers need to be strongly encouraged to comply with U.S. tax laws. This is validated through the small numbers of taxpayers that use both programs compared to the millions of Americans that hold foreign accounts. While the IRS has ended most of the voluntary disclosure programs, if the IRS ever chooses to start up the voluntary disclosures again an increase in the amount of penalties should be considered.

The penalties structure should be similar to the suggestions at the end of Chapter 4. Meaning that for those that truly were not aware of the obligations they were under a reasonable exception should apply. If a taxpayer has no idea of the obligation they are under to file or disclose accounts – as in the example of the child born in Denmark to a U.S. citizen – then what is the point of punishing behavior that was not done intentionally? For this reason, as a few academics also argue, a reasonable exception should exist for those that are unaware of their obligations or who make an innocent mistake. The burden should be on the IRS to prove that a reasonable exception did not exist and, therefore, the taxpayer should be subject to the penalty scheme. Conversely, for those cases where there is evidence that the taxpayer has been evading taxes then the penalty scheme should apply but it should be much higher - 60% as suggested in the FBAR chapter - than the 27.5% of the last disclosure program. The burden in this scenario should fall on the taxpayer to prove that they did not intentionally evade taxes or refuse to disclose foreign accounts.

[606] Alfred Bender, *Domination and Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons With the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 291 (Spring 2013).

Another reason for the small number of those that chose to use the voluntary programs is possibly that some are not aware of the programs and the opportunities to voluntarily disclose their foreign accounts. Some might not even be aware that they have an obligation to report their accounts and continue filing tax returns. Since the population of the U.S. living abroad is almost 9 million, the IRS should spend some money in advertising and/or educating – as suggested for the FBAR in the previous chapter – this population on the requirements of the filing obligations while living abroad. This could be in conjunction with the U.S. Department of State. For example, around tax time an embassy could send a reminder out to the citizens it has record of living in that country reminding them of their general filing obligations such as tax returns, FBARs, and any FATCA (Foreign Account Tax Compliance Act – Chapter 9) obligations while also reminding it may not be all the obligations they fall under. At the end of the email, the State Department can link to the IRS website. As far as the U.S. taxpayers living in the U.S., it is much easier to advertise and educate those U.S. taxpayers who are resident in the U.S.

Largely, though, the reason for the low participation is due to tax evasion. Even if 1 million U.S. taxpayers participated in the programs, it would still be insignificant compared to the estimated 9 million Americans living abroad, the millions of resident Americans and the countless number of non-resident taxpayers who hold foreign accounts.

Using these voluntary disclosure programs still bring some non-compliant taxpayers in and should not be completely discounted. But they do not overwhelmingly help the IRS obtain U.S. taxpayer information on foreign accounts. They are only a small piece of the larger puzzle of obtaining taxpayer information. The programs need be used in conjunction with the other measures. The IRS should think about reinstating the voluntary disclosure programs even for the small amount of information that they get from them. This information can lead to investigations on a wider scale that allow for the IRS to utilize the John Doe summons (See next chapter) to require third parties to hand over information on U.S. taxpayers that might have financial

accounts offshore. Without the voluntary compliance of U.S. taxpayers, however small, some of these tax schemes would go unnoticed.

The last two chapters have considered the initiatives that the IRS uses to encourage voluntary compliance through the taxpayer themselves. Despite the small amount of success that the voluntary disclosure programs and the FBAR have seen, the IRS has another anti-tax evasion measure to procure taxpayers' information abroad by means of third parties: the John Doe summons. This is the focus of the subsequent chapter.

CHAPTER 6. JOHN DOE SUMMONS

6.1. INTRODUCTION

As the chapters on FBAR (4) and Voluntary Disclosures (5) show thus far the U.S. government has two anti-tax evasion measures at their disposal that try to obtain taxpayer information on foreign accounts through the taxpayers' compliance through voluntary disclosure. The resulting determination is that both the FBAR and the voluntary disclosure programs do not work efficiently because the two measures only bring in taxpayers who are not willfully evading their tax obligations.

The subject of the present chapter – John Doe summons – is a legal process occurring through the judicial system that uses non-governmental third parties to attempt to procure U.S. taxpayers' information on foreign accounts. This contrasts with the previous two chapters whose measures target the taxpayer themselves.

As the chapter will show, the John Doe summons is an investigatory measure that is submitted to the courts for the purpose of procuring information on unknown taxpayers via non-governmental third parties. The chapter first examines the John Doe summons and how the summons, as an anti-tax evasion measure, gives the U.S. government access to information on U.S. taxpayers' foreign accounts and how the summons procures that information. The chapter then gives a few examples of John Doe summons that have been issued. The concluding section addresses two issues. First, whether using the John Doe summons allows the U.S. government to obtain the information they are seeking on U.S. taxpayers' foreign accounts and, second, if using the summons does not allow for the government to obtain the information they are seeking, what can be done to ensure the ability of the John Doe summons in procuring that information.

6.2. JOHN DOE SUMMONS EXPLAINED

To gain the information that is otherwise not attainable or difficult to obtain, the Internal Revenue Service sometimes uses a specific information gathering measure which is known as a "John Doe summons".[607] A general summons[608] is a summons where the IRS seeks information on a taxpayer whose identity is known and for the purpose of determining the correctness of any return, making a return or determining the liability of any person for internal revenue tax.[609] In furtherance of the goal of the summons, the Secretary of the Treasury has authorization to examine records and documents, to have witnesses, including the taxpayer, testify under oath and to order the production of said records and documents.[610] What exactly is a John Doe[611] summons? In contrast to a general summons, a John Doe summons has unknown taxpayers that cannot be identified.[612]

The John Doe summons, which has been somewhat successful in the battle against tax evasion and use of offshore financial institutions[613], is used to obtain information and records from a third party – such as VISA or FedEx – about a class of taxpayers that are unknown since that information cannot be obtained through the financial institution or taxpayer themselves. This is allowed by the courts when the IRS has a

[607] 26 U.S.C. 7609 (f)
[608] Summons issued by the IRS are administrative summons because the IRS (as well as the Department of the Treasury, the parent agency) are in the Executive branch of the U.S. federal system and those resources are known as administrative legal resources.
[609] 26 U.S.C. § 7602(a).
[610] 26 U.S.C. §7602 (a)(1)-(3).
[611] The term "John Doe", "Jane Doe", "Richard Roe" or "Jane Roe" is a fictional name used to either protect the identity of a person or to designate a person whose identity is unknown who is a party to legal proceedings.
[612] Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574 (1984); *See also*, Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29 (Fall 2017); International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, (2013).
[613] Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29, 32 (Fall 2017) (See footnote #1).

reasonable suspicion that those taxpayers are engaged in (or are engaging in) illegal conduct – such as evading taxes - that violates U.S. law.[614]

6.2.1. PROCEDURE/AUTHORITY FOR OBTAINING A JOHN DOE SUMMONS

6.2.1.1 General Summons

The IRS cannot just issue a summons without authority to do so, so where does the IRS get the authority to serve a summons? The authority for this summons is found under 26 U.S.C. §7601. This statute gives the IRS the authority to investigate and inquire after taxpayers who might be liable to pay taxes.[615] In order to fulfill that responsibility, the IRS has been given a general summons power found under 26 U.S.C. §7602 that expands upon that investigatory power[616] and, generally, this type of summons identifies a known person. In order to investigate the *"correctness of any return, making a return where none has been made, determining the liability of any*

[614] U.S. Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidaries in Jurisdictions Listed As Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157, 11 (December 2008); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 292 (Spring 2013); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016).

[615] 26 U.S.C. §7601; Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and a Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 194 (Fall, 2010); Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29 (Fall 2017); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 292 (Spring 2013); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016); T. Keith Fogg, *Go West: How the IRS Should Foster Innovation In Its Agents*, 57 Vill. L. Rev. 441, 456 (2012).

[616] 26 U.S.C. §7602; Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 194 (Fall, 2010); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 292 (Spring 2013); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 153 (Palgrave MacMillian, 2016).

person for any internal tax revenue…..or collecting any liability"[617] *the IRS has the authority to examine "any books, papers, records, or other data, which may be relevant or material to such inquiry*."[618] The IRS also has the authority to summon the taxpayer or any person that has possession, custody or care of books of account that pertain to the business of the taxpayer as well as to take the testimony of said persons or anyone who is relevant or material to the investigation.[619]

In order to judicially enforce a §7602 summons, the IRS must establish four elements which provide a limitation to the general summons power.[620] These four elements – established in *United States v. Powell* and colloquially known as the "*Powell* factors" – are:

1) *The investigation is being conducted for a legitimate purpose;*
2) *The inquiry may be relevant to that purpose;*
3) *The information is not already within the government's possession; and*
4) *The IRS has complied with the administrative requirements of the USC.*[621]

Once the IRS has established the above factors, the burden then shifts to the taxpayer to challenge the enforcement of the general summons.[622]

[617] 26 U.S.C. §7602(a); *See also*, T. Keith Fogg, *Go West: How the IRS Should Foster Innovation in Its Agents*, 57 Vill. L. Rev. 441, 456 (2012).
[618] 26 U.S.C. §7602(a)(1); *See also*, *U.S. v. Bisceglia*, 420 U.S. 141, 144-145 (1975).
[619] 26 U.S.C. §7602(a)(2)-(3); *See also*, T. Keith Fogg, *Go West: How the IRS Should Foster Innovation in Its Agents*, 57 Vill. L. Rev. 441, 456 (2012).
[620] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, (2013).
[621] *United States v. Powell*, 379 US 48 (1964)*; See also*, Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29, 30 (Fall 2017).
[622] *United States v. Powell*, 379 US 48 (1964); *See also*, Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29, 30(Fall 2017).

6.2.1.2 John Doe Summons

While both the known and unknown taxpayer scenarios are relevant to this thesis. The known taxpayer scenario does not present the same issues as the unknown taxpayer in that the known taxpayer can be brought before the court via the general summons power because the identity of the taxpayer is not in question. However, when the taxpayer is unknown to the IRS this presents a separate set of problems. For instance, the IRS may be aware of – through a voluntary disclosure program – that a certain bank in the Bahamas is providing their U.S. clients Visa debit cards to withdraw funds. But what they cannot know is the identity of all the U.S. clients based on the jurisdiction's secrecy rules. How can the IRS ascertain whether these U.S. taxpayers – with the knowledge that the Bahamas is a jurisdiction that provides secrecy in their financial sector – are in compliance with their tax obligations? The answer to this question lies in the holding of the U.S. Supreme Court case, *United States v. Bisceglia*.

In *United States v. Bisceglia*, the U.S. Supreme Court held that the IRS had authority to issue a "*John Doe*" summons in order to discover the identity of taxpayers when there is a possibility that those unknown taxpayers may have failed to comply with their legal tax obligations by compelling a bank to make available private individuals records for inspection.[623] Congress, in order to protect taxpayers' privacy and in response to the *Bisceglia* decision, enacted 26 U.S.C. §7609(f) as a limitation to the

[623] *U.S. v. Bisceglia*, 420 U.S. 141 (1975); See also, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574 (1984); Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 194 (Fall, 2010); Nancy C. Staudt, Rene Lindstadt and Jason O'Connor, *Judicial Decisions as Legislation: Congressional Oversight of Supreme Court Tax Cases*, 1954-2005, 82 N.Y.U. L. Rev. 1340, 1362-1363 (Nov. 2007); Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax Law. 29, 31 (Fall 2017); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 29 (Spring 2013).

IRS' power by requiring judicial approval for the issuance of a John Doe Summons in which the Secretary of the Treasury (IRS) has to meet three elements.[624]

When the taxpayers are unknown, the IRS must establish that three elements exist in addition to the *Powell factors* to issue a John Doe summons[625]:

> *1) the summons relates to the investigation of a particular person or ascertainable group or class of persons who identity is unknown,*
>
> *2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provisions of any internal revenue law, and*
>
> *3) the information sought to be obtained from the examination of the records or testimony and the identity of the John Doe(s) is not readily available from other sources.*[626]

The reasoning behind allowing John Doe summonses is that no investigation could occur if the IRS had to ascertain the identity of the taxpayer.[627] This is especially true in situations where the money and information is inaccessible to the IRS due to being

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[624] 26 U.S.C. §7609(f); See also, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574, 575 (1984); Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010).
[625] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 292-293 (Spring 2013); See also, Internal Revenue Manual, pt. 25.5.7.5 (2-18-16).
[626] *U.S. v. Bisceglia*, 420 U.S. 141, (1975); 26 U.S.C. §7609(f); See also, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574, 575 (1984); Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax Law. 29, 30 (Fall 2017); *Third-Party Summons For Unknown Taxpayer – John Doe Summons*, Fed. Tax Coordinator, Chapter T – Audits, Tax Deficiencies, Refunds, Settlements, T-1276 (Nov. 2018); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 175 (Palgrave MacMillian, 2016).
[627] *U.S. v. Bisceglia*, 420 U.S. 141, 150 (1975).

offshore or because of the secrecy laws of another jurisdiction.[628] The court explains that "*it would seem elementary that no meaningful investigation of such events could be conducted if the identity of the persons involved must first be ascertained, and that is not always an easy task. Fiduciaries and other agents are understandably reluctant to disclose information regarding their principals…. Moreover, if criminal activity is afoot the persons involved may well have used aliases or taken other measures to cover their tracks. Thus, if the Internal Revenue Service is unable to issue a summons to determine the identity of such person, the broad inquiry authorized by §7601 will be frustrated in this class of cases*."[629] As Robert W. Wood sums it up "…*the IRS uses John Doe summonses to obtain information about possible violations of internal revenue laws by others, individuals whose identities are unknown*."[630]

The IRS employs the John Doe summons power after collecting ample information that strongly implies that an identifiable group of taxpayers are non-compliant in a significant area of tax law but that the individuals members of the group are unknown or substantially unknown to the IRS.[631] This scenario generally occurs due to bank secrecy in certain jurisdictions.[632] It usually pursues John Doe summonses in situations where the IRS stumbles on individuals of a group in the auditing process or through another program like the Offshore Voluntary Disclosure Program (OVDP) (discussed in Chapter 5).[633] The IRS realizes, through happening upon the information

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[628] *U.S. v. Bisceglia*, 420 U.S. 141, 150 (1975).
[629] *U.S. v. Bisceglia*, 420 U.S. 141, 150 (1975); *See also*, Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax Law. 29, 31 (Fall 2017).
[630] Robert W. Wood, *IRS Hunts Debit Cards For Tax Evasion, As Court Approves John Doe Summons*, Forbes (January 25, 2017), *found at* https://www.forbes.com/forbes/welcome/?toURL=https://www.forbes.com/sites/robertwood/2017/01/25/irs-hunts-debit-cards-for-tax-evasion-as-court-approves-john-doe-summons/&refURL=&referrer=
[631] T. Keith Fogg, *Go West: How the IRS Should Foster Innovation In Its Agents*, 57 Vill. L. Rev. 441, 456-457 (2012).
[632] T. Keith Fogg, *Go West: How the IRS Should Foster Innovation In Its Agents*, 57 Vill. L. Rev. 441, 456-457 (2012).
[633] T. Keith Fogg, *Go West: How the IRS Should Foster Innovation In Its Agents*, 57 Vill. L. Rev. 441, 456-457 (2012).

that these programs provide, that many other taxpayers are likely in the same situation.[634]

In another U.S. Supreme Court case, the Court outlined the good faith requirements that the IRS must establish in order to present a prima facie case for the enforcement of a summons.[635] To establish that the IRS has met the good faith requirements, the IRS must show that the four factors of the *Powell* case (as listed above) has been met.[636]

The IRS has the minimal burden of establishing the rebuttable presumption, but that presumption can be met by simply submitting to the court an affidavit[637] by an IRS agent.[638] This affidavit complies with the Congressional approach that favors disclosure of any and all information that is relevant to a valid IRS investigation.[639] This approach is also reflected in the heavier burden that the taxpayer has, once the burden shifts, of refuting any of the established elements from the *Powell* case.[640] The taxpayer has the burden showing that the IRS is abusing the court's process by

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[634] T. Keith Fogg, *Go West: How the IRS Should Foster Innovation In Its Agents*, 57 Vill. L. Rev. 441, 456-457 (2012).
[635] *United States v. Powell*, 379 U.S. 48, 58 (1964).
[636] *United States v. Powell*, 379 U.S. 48, 58 (1964); See also, Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010).
[637] An affidavit is a voluntary declaration of facts written down and sworn to by the declarant before an officer authorized to administer oaths and can be used as evidence. (Black's Law Dictionary, Bryan A. Garner, ed., 7th edition, 1999).
[638] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010) (citing *United States. v. Stuart*, 489 U.S. 353 (1989) and *United States v. Arthur Young & Co*., 465 U.S. 805 (1984)).
[639] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010) (citing *United States. v. Stuart*, 489 U.S. 353 (1989) and *United States v. Arthur Young & Co*., 465 U.S. 805 (1984)).
[640] *U.S. v. Powell*, 379 U.S. 48, 58 (1964); See also, Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013).

establishing that the IRS either issued a summons in bad faith – for example, issuing a summons for an improper purpose – or that there was harassment of the taxpayer.[641]

After the Supreme Court's holding in *Bisceglia,* Congress became concerned that there was nothing to limit the IRS' John Doe summons power and that the party summoned would not have an interest in protecting the records from disclosure and, therefore, the IRS would have no opponent that would question the summons.[642] Therefore, Congress enacted 26 U.S.C. §7609(f) in order to limit the IRS' power to issue summonses. The purpose behind the enactment of the statute was to prohibit fishing expeditions[643] into taxpayers' records. This statute specifically applies to "*any summons….which does not identify the person with respect to whose liability the summons is issued*…."[644] In the words of the Western District Court of Oklahoma, the John Doe summons is a statutory procedure that has "*placed the federal courts between the government and the person summoned to protect against the abusive use of governmental powers*."[645] The elements required to prove a John Doe summons provides some reassurance that the information that is sought through the summons is not a fishing expedition but is applicable and material to a valid IRS investigation despite not knowing the identity of the taxpayer(s).[646]

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[641] *U.S. v. Powell*, 379 U.S. 48, 58 (1964).
[642] *Matter of Oil Gas Producers, Etc*., 500 F. Supp. 440 (W.D. Okla. 1980); See also, Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 197 (Fall, 2010); Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29-30 (Fall 2017).
[643] 26 U.S.C. §7609(f); Megan L. Brackney, *Meet John Doe Summonses*, 32 No. 1 Prac. Tax L. 29-30 (Fall 2017); *See also*, *Matter of Oil Gas Producers, Etc.*, 500 F. Supp. 440 (W.D. Okla. 1980); Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 197 (Fall, 2010).
[644] 26 U.S.C. §7609(f); See also, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574, 576 (1984).
[645] *Matter of Oil Gas Producers, Etc.*, 500 F. Supp. 440 (W.D. Okla. 1980); See also, Cecelia Kehoe Dempsey, *The Application of the John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 Fordham L. Rev. 574, 580 (1984).
[646] *Tiffany Fine Arts, Inc., v. U.S.*, 469 U.S. 310 (1985); *See also,* Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29 (Fall 2017).

6.2.1.3 Ability to Quash a John Doe Summons

A U.S. taxpayer can go to court and pursue a motion to quash.[647] The taxpayer has to demonstrate to the court that there are legitimate legal reasons to prohibit disclosure of the information being sought.[648] If the taxpayer is successful in getting the John Doe summons quashed, the enforcement is denied and the third party does not have to relinquish the information.[649] The third party that is being summoned does not have the ability to pursue a motion to quash which will be discussed in more detail further down.[650]

There are multiple reasons a court may quash a summons, and in relation to this chapter, a John Doe Summons. The courts may quash a John Doe summons when it is overbroad, when it constitutes abuse of process or when it conflicts with a foreign law.[651]

The courts may quash based upon an abuse of process.[652] One court defined it this way: "*Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, or for any other purpose reflecting on the good faith of a*

[647] 26 U.S.C. §7609(b)(1)-(2).
[648] Harris Bonnette, Jr., *The IRS and Their Pesky Summonses: A Primer on Enforcement and Common Defenses*, 90 Florida Bar J. 36 (December 2016).
[649] Harris Bonnette, Jr., *The IRS and Their Pesky Summonses: A Primer on Enforcement and Common Defenses*, 90 Florida Bar J. 36 (December 2016); *See also*, Department of Justice, Tax Division, *Summons Enforcement Manual*, 27 (Frank P. Cihlar, et al. 2011).
[650] 26 U.S.C. §7609(a)(1); *See also*, Department of Justice, Tax Division, *Summons Enforcement Manual*, 27 (Frank P. Cihlar, et al. 2011).
[651] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196 (Fall, 2010); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013).
[652] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196 (Fall, 2010); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013).

particular investigation".[653] In order to qualify as an abuse of process, the misconduct has to be egregious or done in bad faith.[654]

Another justification for quashing a summons is when the summons is overbroad. The courts have differed in their opinions as to what qualifies as overbroad and these divisions seem to run along liberal versus conservative[655] lines at the appellate level.[656] Some courts define an overbroad summons broadly as a summons that "*is out of proportion to the ends sought*", while other courts define it more narrowly.[657] The government will not be allowed to take a "*rambling exploration*" through third parties' files nor will a fishing expedition be permitted in the hopes that it will reveal evidence of a crime.[658] Conversely, the narrow definition of an overbroad summons is defined as a summons that "*does not advise the summoned party what is required of him with sufficient specificity to permit him to respond adequately to the summons.*"[659] The Supreme Court has declined to restrict the breadth of the summons

[653] *U.S. v. Powell*, 379 U.S. 48 (1964); See also, *U.S. v. Stuart*, 489 U.S. 535 (1989); Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196 (Fall, 2010).

[654] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196 (Fall, 2010) (citing *Beaumont Key Servs., L.L.C. v. United States*, 2005 WL 2007100, 2 (N.D. Tex. Aug. 19, 2005).

[655] The 3rd, 4th, 9th and 11th circuit (appellate) courts are generally considered liberal while the 1st, 2nd, 5th, 7th and 8th are considered conservative. *See* Andreas Broscheid, *Comparing Circuits: Are Some U.S. Courts More Liberal or Conservative Than Others?*, 45 L. & Soc. Rev. 171 (March 2011) for a discussion on circuit courts that are liberal versus conservative.

[656] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196 (Fall, 2010)

[657] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 195 (Fall, 2010) (citing *United States v. Harrington*, 388 F.2d 520, 523 (2d. Cir. 1968)(quoting *McMann v. SEC*, 87 F.2d 377)(2d. Cir. 1937)); See also, *Standing Akimbo, LLC v. United States*, 2018 WL 6791104 (D. Colo. August 6, 2018) (citing *U.S. v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977).

[658] *U.S. v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977); *See also, United States v. Harrington*, 388 F.2d 520, 523 (2d. Cir. 1968); *U.S. v. Theodore*, 479 F.2d 749 (4th Cir. 1973).

[659] *United States v. Wyatt*, 637 F.2d 293 (5th Cir. 1981); See also, *U.S. v. Medllin*, 986 F.2d 463 (11th Cir. 1993); Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 196-197 (Fall, 2010)

authority given to the IRS lacking any explicit directions from Congress itself and noted itself the inter-circuit conflict[660] regarding this issue.[661] This gives deference to the language in 26 U.S.C. 7602(a) which reflects the broad latitude that Congress gave to the IRS that favored disclosure of all information relevant or material to such inquiry.[662]

Considering that the Supreme Court has not specifically addressed the issue of "*overbroad*" in the John Doe summons context, one way to predict what the Court might do would be to look at the analogous issue of a third-party subpoenas duces tecum. A third-party subpoena duces tecum is a written order by the court commanding a third party to appear in court and bring specified documents or records.[663] This is analogous to the John Doe summons used for tax purposes as that is, likewise, a written order summoning a third party to provide information on a unknown taxpayer that has potential tax liability as noted above. Both the John Doe summons and the third-party subpoena duces tecum require the third party to provide documentation and both requests on the documentation can involve a question of whether the request for that documentation is too broad. Furthermore, the subpoena duces tecum has a couple tests that it must be evaluated against before it can be issued that are comparable to the tests that the John Doe summons must meet. In the first test, it has to be shown that the documents being requested under the subpoena are evidentiary and relevant, they are not otherwise procurable, trial cannot properly be prepared for without such production and the application for the subpoena is made in good faith and is not intended to be a fishing expedition.[664] The second test, according to the Supreme Court, has three hurdles that the prosecutor has to clear to have the

[660] Meaning the division of opinions at the appellate (circuit) court level.
[661] *U.S. v. Barrett*, 837 F.2d 1341 (5th Cir. 1988) (noting that the Supreme Court has declined to restrict the broadness that the IRS has in its summons power).
[662] *U.S v. Jose*, 131 F.3d 1325 (9th Cir. 1997); *See also*, *U.S. v. Barrett*, 837 F.2d 1341 (5th Cir. 1988).
[663] Black's Law Dictionary, 7th edition (Editor Bryan A. Garner 1999).
[664] *U.S. v. Nixon*, 418 U.S. 683 (1974) (quoting *U.S. v. Iozia*, 13 F.R.D. 335, 338 (S.D.N.Y. 1952)).

subpoena issued. Those hurdles are relevancy, admissibility and specificity which are also comparable to the John Doe requirements.[665]

In the third-party subpoena cases that address the breadth issue, the courts have held that the subpoena should not be used as a "*broad discovery device*" in the hopes that asking for a broad array of documents will increase the change that some tidbit of illegal behavior will turn up that would be helpful.[666] In fact, the Supreme Court has stated that it is "*contrary to the first principles of justice to allow a search*[667] *through all the respondents' records, relevant or irrelevant, in the hope that something will turn up.*"[668] A few of the district courts have held that in order to not be overbroad, "*the time covered by the subpoena must be reasonably limited and the subject matter of the documents called for must be specified with reasonable particularity*."[669] One court goes a bit further and states a request for a subpoena should relate to a specific time, place or person.[670] The Supreme Court decisions back up this specificity requirement by stating that the subpoena should specify a reasonable period of time and be reasonably particular regarding the subjects to which the documents called for relate.[671] However, at the same time, it cannot be so specific that the party requesting the subpoena has to detail each particular piece of documentation they desire.[672]

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[665] *U.S. v. Nixon*, 418 U.S. 683 (1974).
[666] *Federal Trade Commission v. American Tobacco Co*., 264 U.S. 298 (1924); See also, *U.S. v. Cuthbertson*, 630 F.2d 139 (3rd Cir. 1980); *Gilmore v. U.S*., 265 F.2d 565 (5th Cir. 1958); *App. Of Certain Chinese Family Benevolent and District Assoc.,* 19 F.R.D. 97 (N.D. Calif. 1956).
[667] This is also a 4th amendment issue but that is beyond the scope of this thesis and could have a dissertation written solely on that topic.
[668] *Federal Trade Commission v. American Tobacco Co*., 264 U.S. 298 (1924).
[669] *In Re Eastman Kodak Co.,* 7 F.R.D. 760 (W.D.N.Y. 1947); *See also, U.S. v. Maloney*, 37 F.R.D. 441, 446 (W.D. Penn. 1965) (quoting *In Re Eastman Kodak Co.,* 7 F.R.D. 760 (W.D.N.Y. 1947)).
[670] *Application of Certain Chinese Family Benevolent and Dist. Assoc*., 19 F.R.D. 97 (N.D. Calif. 1956).
[671] *Consolidated Rendering Co. v. State of Vermont*, 207 U.S. 541 (1908); See also, *Brown v. U.S.*, 276 U.S. 134 (1928).
[672] *Consolidated Rendering Co. v. State of Vermont*, 207 U.S. 541 (1908); See also, *Brown v. U.S*., 276 U.S. 134 (1928).

Another way to predict what the Court might do in the future should they choose to hear a case on the issue of broadness in a summons, is to examine a few cases that point to how the Supreme Court might decide. First, in *U.S. v. Morton Salt Co. (1950)*, the Court stated that *"the judicial subpoena power* (**which is analogous to the summons power given to the IRS**[673]) *not only is subject to specific constitutional limitations……but also is subject to those limitations inherent in the body that issues them because of the provisions of the Judiciary Article of the Constitution.*"[674] The Court further stated that the federal judicial power extends only to the adjudication of cases and controversies and, therefore, the investigative powers it holds "*should be jealously confined to these ends*."[675] The *Powell* court (1964) then set forth the four *Powell* criteria that was discussed above, followed a decade later by the *Bisceglia* court (1975) which held that a John Doe summons is appropriate where the person is unknown lest the purpose of the broad inquiry of 26 U.S.C. §7601 is frustrated.[676] *Bisceglia* qualified that, understanding that the summons power could be abused by conducting fishing expeditions, stated "*….the solution is not restrict that authority so as to undermine the efficacy of the federal tax system….Substantial protection is afforded by the provision that an Internal Revenue Service summons can be enforced only by the courts*."[677] Fishing expeditions are too broad, however, limiting the summonses to investigations that already have a focus – either on a particular return, person or potential tax liability – is too narrow because it contradicts the language in 26 U.S.C. §7602 and has to include the possibility of a unknown person, or a John Doe.[678] These decisions give the definition of broad as somewhere between a fishing expedition (too broad) and focusing on a particular person, return or tax liability (too narrow). These appellate cases seem to follow the third-party subpoena duces tecum holdings: cannot be a fishing expedition yet cannot be so specific as to detail out each document.

[673] Author's emphasis
[674] *U.S. v. Morten Salt. Co*., 338 U.S. 632 (1950).
[675] *U.S. v. Morten Salt. Co*., 338 U.S. 632 (1950).
[676] *U.S. v. Bisceglia*, 420 U.S. 141 (1975).
[677] *U.S. v. Bisceglia*, 420 U.S. 141 (1975).
[678] *U.S. v. Bisceglia*, 420 U.S. 141, 149 (1975).

In trying to predict what the Court might do in the future it could also be significant to consider the Court's makeup between conservatives and liberal justices. With the most recent nomination and confirmation of Justice Kavanaugh, many Supreme Court experts believe the Court will shift to a slightly more conservative viewpoint.[679] Should the current presidential administration remain in power through the next election cycle, it is possible that another conservative justice — considering the age and health of Justice Ginsburg — would be appointed to the Court. Should that happen, a shift to the more conservative viewpoint would seem even more likely.

Given the analysis of the third-party subpoena duces tecum cases, the summons cases and the above consideration of the composition of the Supreme Court, a decision on what is considered "*overbroad*" in order to give guidance to the lower courts, the Supreme Court would look to the cases described above as well as the language of the appropriate statutes. The Court, as it sits now, leans conservative and probably will for years to come and because conservatives generally favor limited government as noted above, the decisions the court makes will also probably be conservative.[680] In light of this assessment – the view of limited government and the reasoning in the above cases – the Supreme Court, as it sits today, in considering what overbroad means within the John Doe context would most likely hold for a more narrow definition of overbroad which would possibly align with the holding that a summons (and a subpoena) should specify a reasonable time period and should describe the

[679] The Economist, *If Donald Trump Gets Another Supreme Court Pick (*May 16, 2019), *found at* https://www.economist.com/united-states/2019/05/18/if-donald-trump-gets-another-supreme-court-pick; *See also,* Abigail Simon, *The Era of the Swing Justice is Over. Here's How Democrats May Adapt*, Time (August 13, 2018), *found at* http://time.com/5363918/supreme-court-brett-kavanaugh-conservative-bloc/

[680] Texas GOP, *Conservative Principles*, https://www.texasgop.org/conservative-principles/ ; *See also*, Indiana Republican Party, 2018 Platform, http://indiana.gop/sites/default/files/2018%20Platform%20Final.pdf

documents needed with reasonable detail so as to avoid a potential fishing expedition. [681]

Another reason the courts may quash a summons is comity which is the legal principle that courts from different jurisdictions will mutually recognize and show deference to a foreign government's legislative, executive and judicial acts.[682] This principle and substantive issue is applicable to this chapter because countries like Switzerland and others have enacted banking secrecy into their legislation which does not allow their bankers to reveal information about their clients to foreign governments.[683] This creates issues for the IRS when investigating taxpayers that have accounts overseas and being able to obtain the information needed to administer the laws.[684] Therefore, when a summons conflicts with a foreign law, a U.S. court *may* quash the summons.[685] The Supreme Court has held that courts have wide discretion in deciding how to evaluate cases on international comity.[686] This, in turn, has resulted in discrepancies

[681] *Consolidated Rendering Co. v. State of Vermont*, 207 U.S. 541 (1908); See also, *Brown v. U.S.*, 276 U.S. 134 (1928); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013) (Also coming to the conclusion that the court would narrow the scope of the John Doe Summons).
[682] https://www.law.cornell.edu/wex/comity ; See also, Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 200 (Fall, 2010).
[683] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 199 (Fall, 2010).
[684] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 199 (Fall, 2010).
[685] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 199 (Fall, 2010)(citing *Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 213 (1958)); Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013).
[686] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013) (citing *Societe Internationale Pour Participations Industrielles Et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 213 (1958)).

in the decisions of the circuit courts.[687] Alfred Bender, when looking at cases of international comity, found commonalities among the lower courts' decisions which points to who the stronger supporters of the John Doe summons are.[688] He found that courts were more likely to affirm the John Doe summons if "(*1) the privacy interest the foreign state seeks to protect is that of an American citizen, (2) the venue was deliberately chosen to avoid following United States law and the conflict could have been avoided by following United States law from the onset; and (3) duress is a defense to the domestic law in conflict."*[689] On the opposite side are the courts that are less likely to affirm a John Doe summons, like the 11th circuit, especially when certain conditions are met.[690] Those conditions are *"(1) the information being sought through the summons is available through means that do not require the breaking of a foreign jurisdictions' law; (2) the foreign jurisdiction's law's protection arose naturally, as opposed to as a result of an attempt to evade United States law; and (3) the party being served acted in good faith."*[691]

The move to quash a John Doe summons cannot come from the summoned party because of the designated ex-parte nature that the legislature intended for the

[687] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 293 (Spring 2013).
[688] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 294 (Spring 2013) (comparing *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984) with *United States v. First National Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983)).
[689] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 294 (Spring 2013).
[690] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 294 (Spring 2013).
[691] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty With Switzerland*, 4 Geo. Mason J. Int'l Comp. L. 289, 294 (Spring 2013) (citing Emily Ann Busch, Note, *To Enforce or Not to Enforce? The UBS John Doe Summons and a Framework for Policing U.S. Tax Fraud Amid Conflicting International Laws and Banking Secrecy*, 83 Temp. L. Rev. 185, 201-203 (2010)).

procedure.[692] The remedy that the summoned party does have, for both general and John Doe summonses, is to challenge the summons *after* the enforcement action has been brought. Even then the summoned party is limited to only challenging the failure of the government – in a limited evidentiary hearing — to comply with the *Powell* factors or challenge on the basis of bad faith or abuse of process.[693] The 2nd Circuit's interpretation of the legislative history is that Congress never intended – based on the requirement of the ex parte application – for the allowance of a summoned party to challenge the elements proven in order to issue the summons.[694] As Megan Brackey points out in her article and with sound logic, a John Doe summons target is highly unlikely to challenge the enforcement of the summons since doing so would identify the target as someone the IRS should be focusing on.[695] This is the type of person that anti-tax evasion measures – especially those measures considered in this thesis – want to truly target: those that intentionally evade paying taxes by concealing assets in foreign accounts.

In chapter 5, the voluntary disclosure programs were discussed. Those programs have relevance in this chapter because sometimes the information disclosed through one of those programs leads the IRS to suspect that there are more Americans that are concealing money in a similar manner to the disclosed case. Another related program the IRS has offered that works in tangent with the John Doe summons is the Offshore Credit Card Program (OCCP).[696] Credit cards provide easy access to offshore funds

[692] 26 U.S.C. §7609(h)(2); *See also*, 26 U.S.C. §7609(a)(1) and (b)(2); *Tiffany Fine Arts, Inc., v. U.S.*, 469 U.S. 310, 317 (1985).
[693] Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29, 32 (Fall 2017); *See also*, *Third-Party Summons for Unknown Taxpayer – John Doe Summons*, Fed. Tax Coordinator, Chapter T – Audits, Tax Deficiencies, Refunds, Settlements, T-1276 (Nov. 2018); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 175 (Palgrave MacMillian, 2016).
[694] *In the Matter of the Tax Liabilities of John Does*, 688 F.2d 144, 148-149 (2nd cir. 1982); *See also*, Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29, 32 (Fall 2017).
[695] Megan L. Brackney, *Meet John Doe Summons*, 32 No. 1 Prac. Tax L. 29, 32 (Fall 2017).
[696] IRS, *Offshore Compliance Program Shows Strong Results*, https://www.irs.gov/newsroom/offshore-compliance-program-shows-strong-results; *See also*, David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016).

and accounts in tax haven countries that allow U.S. citizens to conceal their income.[697] One of the big methods used by tax evaders and promoted by offshore financial institutions (FI) is the use of the FI's credit or debit card in order to access the taxpayers' offshore assets but because these credit cards and debit cards are issued from FIs in secrecy jurisdictions, the IRS has not been able to identify the taxpayers that are using them. The OCCP has been used in conjunction with the John Doe summons in order to try to identify taxpayers that were concealing unreported assets in offshore banks.[698] The IRS issued multiple John Doe summonses to major credit card companies like Visa and Mastercard.[699] This was a move by the Treasury Department and the IRS to fight the credit card schemes used by banks and financial institutions in helping U.S. citizens hide income.[700] From March 2002 through at least August of that year, federal judges in both Florida and California issued orders authorizing the IRS to serve John Doe summonses on Visa, Mastercard and American Express.[701] The records obtained through at least one John Doe summons allowed the IRS to establish hundreds of cases for either a civil audit or potential criminal investigations.[702] The IRS, as a next step, had to seek information from assorted businesses because the information gleaned from the John Doe Summonses did not always identify the individual.[703] In order to identify or verify the identities of these individuals, the IRS contacted some of the merchants.[704] These merchants included (but were not limited to) airlines, hotels, rental car companies and internet

[697] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[698] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016).
[699] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016); See also, IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[700] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[701] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[702] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[703] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[704] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp

providers.[705] Between August of 2002 and October of the same year, 110 businesses were served John Doe summonses that were approved by all 11 U.S. District Courts.[706] The IRS made clear it was not the credit card companies nor the businesses that were in the wrong.[707] Instead, the U.S. citizens using the credit cards to dodge their tax responsibilities were the targets.[708]

6.3. EXAMPLES OF THE USE OF THE JOHN DOE SUMMONS

This next section presents several cases to demonstrate how the summonses work when applied in actual situations.

The IRS has requested a John Doe summons in multiple cases[709] to obtain information on U.S. taxpayers who the IRS suspected of failing to declare financial accounts or for failing to report income earned abroad when that information is not available elsewhere. The summonses are directed at third-parties that are financial institutions such as the Federal Reserve Bank of New York or PayPal but also on non-financial institutions such as Fed Ex or UPS (United Parcel Service) because, as the IRS pointed out, "*their (taxpayers) activities are often reflected in business records of legitimate*

[705] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[706] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[707] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[708] IRS, *Offshore Credit Card Program*, https://www.irs.gov/newsroom/offshore-credit-card-program-occp
[709] *In the Matters of the Tax Liabilities of John Does*, 02-cv-046 MISC. (N.D Cal. 2002); *In the Matter of the Tax Liabilities of John Does*, 5:05-cv-04167 PVT (N.D. Cal. 2005); *In the Matters of the Tax Liabilities of John Does*, 2002 WL 32153784 (N.D. Cal. 2002); *In Re: Matter of the Tax Liabilities of John Does*, 2002 WL 32672539 (N.D. Cal. 2002); *In the Matter of the Tax Liabilities of John Does*, 2004 WL 3661851 (S.D. Fla. 2004); *In the Matter of the Tax Liabilities of John Does*, 1:09-cv-00861 (District of Colorado, 2009).

entities."[710] There are multiple examples of cases – such as the case against UBS which is discussed throughout this thesis – where the financial institution hid U.S. taxpayer-held Swiss accounts[711] and the U.S. government then filed a petition to serve a John Doe summons in order to procure information that the IRS could not reach due to bank secrecy rules. [712] For example, some successful John Doe summonses that have been issued were to UBS in 2008, to First Data Corp in 2009 and to HSBC Bank, USA in 2011.[713] The John Doe summons is one anti-tax evasion measure that the U.S. government uses to procure information on U.S. taxpayers' foreign accounts. But does this really solve the entire problem of inaccessibility? The following few pages will discuss and examine a couple of cases to analyze whether this anti-tax evasion measure, when implemented, enables the IRS to obtain the previously inaccessible information.

The John Doe summons are sought because the information the IRS seeks cannot be acquired from the jurisdictions named in the summons (such as Antigua or the Cayman Islands) due to local secrecy laws. Instead, when the typical avenues – such as taxpayer voluntary disclosures or utilizing treaties - that are used to access information fail, another strategy for the IRS to take is to file a John Doe summons. This is an a move to try to obtain the taxpayer information through the third parties who have records of the use of the offshore accounts because the taxpayers have used the services of said third parties – for example, using a credit card to rent a car with a rental company.

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[710] Proposed Order Granting *Ex Parte* Petition for Leave to Serve "John Doe" Summonses, https://www.justice.gov/sites/default/files/usao-sdny/legacy/2015/03/25/Sovereign%20Management%20John%20Doe%20Summonses%20Order.pdf; *See also*, *In the Matter of the Tax Liabilities of John Does*, No. 5:05-cv-04167PVT (N.D. Cal. 2005);
[711] Department of Justice, Press Release, *Federal Judge Approves IRS Summons for UBS Swiss Bank Account Records*, https://www.justice.gov/archive/tax/txdv08584.htm.
[712] Department of Justice, Press Release, *Federal Judge Approves IRS Summons for UBS Swiss Bank Account Records*, https://www.justice.gov/archive/tax/txdv08584.htm.
[713] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 174 (Palgrave MacMillian, 2016).

The following John Doe summonses are obviously not the only summonses that have been issued but the cases examined here were chosen for specific reasons. The PayPal and UBS summonses were both chosen because they were fairly high-profile cases – especially the UBS case – which was alleged to be the turning point in the fight against secrecy. The final summons examined in this section was a more recent case which demonstrates that evasion is still an ongoing problem and that the John Doe summons is only part of the solution.

6.3.1. PAYPAL SUMMONS

In the first example, a John Doe summons was served upon PayPal, its affiliates and subsidiaries because the IRS had some suspicion that unknown U.S. taxpayers who had signature authority over bank accounts and certain types of credit cards that were "*issued by, through or on behalf of banks or other institutions*" had not complied with their U.S. tax obligations.[714] The accounts and credit cards in question were issued in thirty-four jurisdictions who were named in the summons and these actions occurred from 1999 to 2004.[715] Most of the thirty-four jurisdictions named in the John Doe summons can be found on both the EU blacklist or their state of play document[716] and the past OECD list.[717] They are also widely recognized as *"principal offshore tax haven or financial privacy jurisdictions"* throughout the tax law industry.[718] These

[714] *In the Matter of the Tax Liabilities of John Does*, No. 5:05-cv-04167PVT (N.D. Cal. 2005); See also, David E. *Hardesty, Electronic Commerce: Taxation and Planning ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).*
[715] *In the Matter of the Tax Liabilities of John Does*, No. 5:05-cv-04167PVT (N.D. Cal. 2005); See also, David E. *Hardesty, Electronic Commerce: Taxation and Planning ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).*
[716] Press Release, Council of the European Union, *The EU List of Non-Cooperative Jurisdictions for Tax Purposes*, (December 5, 2017), *found at* https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/#; *See also, The EU list of non-cooperative jurisdictions for tax purposes* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2018.403.01.0004.01.ENG&toc=OJ:C:2018:403:FULL
[717] See attached Appendix I with comparative list of tax haven lists, John Doe summons' identified countries, FATCA IGA agreements and TIEAs.
[718] Declaration of Barbara Kallenberg, *In the Matter of the Tax Liabilities of John Does*, No. 5:05-cv-04167-PVT (N.D. Cal. 2005).

offshore jurisdictions usually have strict privacy rules that allow the U.S. taxpayer to hide behind while not reporting income or financial accounts. The financial institutions do not report either simply because they do not have an obligation to. Therefore, to procure information on those U.S. accounts, in this scenario the IRS issued a summons to PayPal, a third party, to release their records because PayPal allows its users to avoid the traditional methods of banking such as wire transfers and, instead, allows them to make payments online through PayPal who serves as the agent for the payment.[719] The PayPal summons alleged that PayPal facilitates users' abilities to evade federal taxes on assets held in offshore accounts within the context of payments funded from foreign financial institutions.[720] The district court granted leave to serve the summons because the IRS met the requirements that were set out in *Bisceglia* and codified in 26 U.S.C. 7609(f).[721] The IRS alleged that the individuals that were the focus of the investigation may have failed (or would fail) to comply with one or more U.S. tax laws.[722] The IRS provided the court with information on: 1) the possibility that certain U.S. taxpayers with foreign bank accounts failed to comply with U.S. federal tax laws and 2) that potential exploitations existed with respect to offshore accounts.[723] The Northern District of California concluded that the John Doe Summons was not a fishing expedition and that this summons would produce results similar to other investigations that the IRS had.[724] Balanced with the above was that even though the IRS did not know the names of those involved and the names could

[719] David E. Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[720] *David E.* Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[721] *David E.* Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[722] *David E.* Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[723] *David E.* Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[724] David E. Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).

not be obtained through the offshore banks due to secrecy laws, their identities could be discovered through the information PayPal could provide.[725]

6.3.2. UBS SUMMONS

The most prominent case where the IRS issued a John Doe Summons was the case against UBS in 2007. This John Doe summons was the largest John Doe summons issued by the IRS.[726] After Bradley Birkenfeld provided information on UBS and its practices, the IRS moved to issue a John Doe summons against UBS instead of utilizing the tax information exchange provision that was in the U.S.-Swiss Treaty.[727] The purpose behind this was to try to force UBS to disclose all of their U.S. taxpayer-held accounts.[728] The court approved the summons, but UBS refused to comply citing that it would violate Swiss secrecy law.[729] The DOJ then negotiated a deferred prosecution agreement with UBS that included the disclosure of U.S. taxpayer-held accounts and a $780 million fine.[730] One of the requirements of the agreement was for UBS to identify roughly 200-300 clients who were U.S. account holders who failed to declare their accounts for U.S. taxation purposes but UBS refused to cooperate with

[725] *David E.* Hardesty, *Electronic Commerce: Taxation and Planning* ¶4.06 (Thomson Reuters/Tax & Accounting 1999 & Cum. Supp. 2019-1).
[726] Emily Ann Busch, To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy, 83 Temp. L. Rev. 185, 209 (Fall, 2010).
[727] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119
[728] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119
[729] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119
[730] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

this as well.[731] The U.S. then immediately filed a motion to get the court to enforce the turning over of the names and UBS once again refused to cooperate.[732] Eventually, the John Doe summons was dropped[733] because the Swiss legislature agreed to releasing the information of 4,450 U.S. account holders as a treaty request, a vast difference from the original 52,000 accounts UBS was suspected of holding.[734]

This case highlighted the difficulty in procuring information on U.S. taxpayer's foreign accounts when two countries customs (banking secrecy) and laws come into conflict with one another. Switzerland has strict banking secrecy laws which would have subjected UBS to criminal prosecution had it disclosed account holders' information in accordance with a John Doe summons.[735] UBS could also have chosen to ignore the summons and refused disclosure but then it would have found itself in contempt of a U.S. federal court.[736] This catch-22 situation that presents itself – either being held in contempt of a federal court or facing criminal prosecution in Switzerland

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[731] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013); See also, William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) found at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[732] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013).; See also, William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-9 (March 1st, 2017) found at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[733] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013).

[734] Emily Ann Busch, *To Enforce or Not to Enforce? The UBS John Doe Summons and A Framework For Policing U.S. Tax Fraud Amid Conflicting International Laws and Bank Secrecy*, 83 Temp. L. Rev. 185, 288 (Fall, 2010)

[735] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013).

[736] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 287 (Spring 2013).

for violating bank secrecy – is one flaw that appears when using John Doe summonses as an anti-tax evasion measure.

6.3.3. MICHAEL BEHR & SML SUMMONS

The final example in this chapter is a 2017 case where the IRS was granted leave to serve a John Doe Summons on Michael Behr. Mr. Behr is the owner and manager of Sovereign Management & Legal LTD (SML) which is a Panamanian company that offers offshore entity formation and management services.[737] The corporation utilizes Panamanian lawyers and other professionals in jurisdictions such as Belize and Hong Kong.[738]

SML initially drew the attention of the IRS because it promoted itself on the internet as a business that would help its' clients conceal their beneficial ownership of offshore assets.[739] The IRS, after uncovering information on SML as a result of another John Doe summons that was issued through the Southern District court of New York[740], sought information on U.S. taxpayers who had received Sovereign Gold debit cards from SML and used the cards as a way to evade their tax obligations from 2005

[737] Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); *See also*, Order Granting *Ex Parte* Petition, *In the Matter of the Tax Liabilities*, CR 17-02-BU-BMM (D. Montana Jan. 18, 2017), *found at*, https://www.justice.gov/opa/press-release/file/931226/download

[738] Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); *See also*, Memorandum of Law in Support of the United States' *Ex Parte* Petition For Leave to Serve John Doe Summons, CR 17-02-BU-BMM (D. Montana, Jan. 18, 2017).

[739] Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); *See also*, Memorandum of Law in Support of the United States' *Ex Parte* Petition For Leave to Serve John Doe Summons, CR 17-02-BU-BMM (D. Montana, Jan. 18, 2017).

[740] *In the Matter of the Tax Liabilities*, Proposed Order Granting *Ex Parte* Petition for Leave To Serve "John Doe" Summonses, *found at* https://www.justice.gov/sites/default/files/usao-sdny/legacy/2015/03/25/Sovereign%20Management%20John%20Doe%20Summonses%20Order.pdf

through 2016.[741] SML offered packages to their clients that allowed the taxpayers to conceal their assets in offshore accounts that were held in the names of nominee officers provided by SML. SML would then open bank accounts in the name of the corporations and issue debit cards in the name of the nominee to the U.S. taxpayer.[742] This allowed the U.S. taxpayer to access their offshore funds without identifying themselves.[743] The John Doe summons was sought for the purpose of ensuring that U.S. citizens who were using certain pre-paid payment card users were meeting their tax responsibilities.[744] The IRS noted in their memorandum of support that SML even boasted that "*its services "[h]elp you avoid foreign account reporting requirements that many countries now have (such as the USA and Germany)*" and that "*it is unlikely, unless you are careless, that such information will ever reach the authorities.*"[745]

The order granting the petition for the John Doe summons was granted on January 18, 2017.[746] SML has continued to be listed as number eleven on the IRS' list of Foreign Financial Institutions or Facilitators which also includes other foreign financial

[741] Department of Justice, Press Release, *Court Authorizes Service of John Doe Summons Seeking the Identities of U.S. Taxpayers Who Have Used Debit Cards in Furtherance of Tax Evasion* (January 25, 2017), found at https://www.justice.gov/opa/pr/court-authorizes-service-john-doe-summons-seeking-identities-us-taxpayers-who-have-used-debit; See also, Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); Robert W. Wood, *IRS Hunts Debit Cards for Tax Evasion, As Court Approves John Doe Summons*, Forbes (Jan. 25, 2017), found at, https://www.forbes.com/sites/robertwood/2017/01/25/irs-hunts-debit-cards-for-tax-evasion-as-court-approves-john-doe-summons/#4f8738c6738b

[742] Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); *See also*, Memorandum of Law in Support of the United States' *Ex Parte* Petition For Leave to Serve John Doe Summons, CR 17-02-BU-BMM (D. Montana, Jan. 18, 2017).

[743] Bruce Zagaris, *Court Authorizes John Doe Summons On U.S. Owner of Panamanian Firm*, 33 No. 2 Int'l Enforcement L. Rep. 47 (Feb. 2017); *See also*, Memorandum of Law in Support of the United States' *Ex Parte* Petition For Leave to Serve John Doe Summons, CR 17-02-BU-BMM (D. Montana, Jan. 18, 2017).

[744] Department of Justice, Press Release, *Court Authorizes Service of John Doe Summons Seeking the Identities of U.S. Taxpayers Who Have Used Debit Cards in Furtherance of Tax Evasion* (January 25, 2017), found at https://www.justice.gov/opa/pr/court-authorizes-service-john-doe-summons-seeking-identities-us-taxpayers-who-have-used-debit

[745] Memorandum of Law in Support of the United States' *Ex Parte* Petition For Leave to Serve John Doe Summons, CR 17-02-BU-BMM (D. Montana, Jan. 18, 2017).

[746] *In the Matter of the Tax Liabilities*, Order Granting *Ex Parte* Petition for Leave To Serve "John Doe" Summonses, *found at* https://www.justice.gov/opa/press-release/file/931226/download

institutions (FFIs) such as UBS AG and Liechtensteinische Landsbanke AG.[747] Michael Behr, owner of SML, himself has made the list at number 145.[748] This list was originally linked to the Offshore Voluntary Disclosure Programs discussed in Chapter 5 which have ended. The purpose of this list is to identify the foreign financial institutions or facilitators that are under scrutiny.[749] The list also identifies those FFIs or facilitators where a public disclosure has been made regarding the FFIs and facilitators:

1. Being under investigation by the IRS or the Department of the Treasury;
2. Cooperating with an ongoing IRS or Department of Justice investigation(s) into accounts that are beneficially owned by U.S. persons; or
3. Having been identified in a court-approved summons seeking information about U.S. taxpayers who potentially hold financial accounts at the foreign financial institution in question or who have had a facilitator establish or maintain an account(s).[750]

A public disclosure could include (but not limited to) a court filing by any party or judicial officer that is considered a public filing or a deferred prosecution agreement that has been publicly disclose by the Department of Justice.[751]

If a U.S. taxpayer is found to have an account with an institution or person listed on the Foreign Financial Institution and Facilitators list, they face a potential 50% penalty

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[747] IRS, *Foreign Financial Institutions or Facilitators*, https://www.irs.gov/businesses/international-businesses/foreign-financial-institutions-or-facilitators

[748] IRS, *Foreign Financial Institutions or Facilitators*, https://www.irs.gov/businesses/international-businesses/foreign-financial-institutions-or-facilitators

[749] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[750] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[751] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

for undeclared accounts instead of at the lower penalty. This applied towards the voluntary disclosure programs – which are not currently in use – and it also applies to programs such as the stream-lined compliance program (also discussed in chapter 5).[752] This penalty is considered an offshore penalty.[753]

6.4. JOHN DOE SUMMONS: CONCLUSION

The John Doe summons is an anti-tax evasion measure that the Internal Revenue Service (IRS) can use to obtain information on U.S. taxpayers' foreign accounts so that it can administer tax laws based on all the information – not just on the facts that the taxpayer wants the IRS to know.

This anti-tax evasion measure's focal point is the taxpayers whose identities are unknown to the IRS at the time of filing but who the IRS suspects of having accounts at foreign financial institutions. These foreign financial institutions issue credit cards so that the taxpayers have access to their accounts. The IRS, who has based their suspicions either on information gleaned from voluntary disclosure programs or from other investigations, uses the John Doe summons to procure the information they cannot get from the foreign financial institutions themselves from third parties who have access to the information.

A John Doe summons is not tool that can just be handed out to the third parties by the IRS. Instead, the IRS has a process they must undergo before a court will grant leave to the IRS to serve the John Doe summons on a third party like FedEx.

There is a bit of push and pull to the John Doe summons process. This means that while the IRS can get the authority to serve the John Doe summons so that the third

[752] Internal Revenue Manual 4.63.3.6 (01-24-2018).
[753] Internal Revenue Manual 4.63.3.6 (01-24-2018).

party must hand over the information, there are some protections for the taxpayer. The U.S. Supreme Court upheld the IRS' authority to issue the summons under *Bisceglia* but Congress moved to limit that authority by enacting 26 U.S.C. §7609(f) which requires judicial approval for the issuance of the summons. To obtain the judicial approval, the IRS must meet the *Powell* factors which requires that the summons is legitimate, relevant, the government does not already possess the information and that the IRS has complied with the United States Code (USC) administrative requirements. Proving the *Powell* factors allows the IRS to prove that the request for the summons has been done in good faith. On top of the *Powell* factors, the IRS has to prove that the summons relates to an investigations of a particular person or ascertainable class of persons, that the IRS has a reasonable basis for believing such person or persons have failed (or may fail) to comply with U.S. tax law and the information sought is not readily available from other sources. All of these requirements are in place to guarantee the IRS is not on a fishing expedition for potential violations. The taxpayer may pursue a motion to quash the John Doe summons, but the summoned third party cannot.

The John Doe summons, like the other anti-tax evasion measures, is not wholly successful at obtaining taxpayer information on foreign accounts because it is limited by multiple issues.

First, for the IRS to utilize a John Doe summons it is dependent on chance occurrences: an IRS agent stumbling onto a questionable taxpayer return, information from a financial account regarding suspect activity, information that filters in through programs such as voluntary disclosure programs or through investigations the IRS itself has or from other agencies. This is demonstrated in the examples above of John Doe summons issued. The extent of the abuse by UBS of the U.S. tax system was not known until Bradley Birkenfeld blew the whistle on the financial institution. The John Doe summons that was granted in the Michael Behr/SML case was based on information uncovered after another John Doe summons was issued through a different district (federal) court.

Another limitation that restricts the success of the John Doe summons as a measure that obtains information on U.S. taxpayers' foreign accounts is that it runs counter to many foreign jurisdictions' bank secrecy laws and regulations. The UBS John Doe summons, if it had not been withdrawn, would have been difficult for UBS to comply with due to the Swiss' banking secrecy laws.[754] The IRS would also have had a hard time enforcing the summons across borders. When issuing a John Doe summons to third parties in the U.S. such as Fed Ex or VISA, this does not present the same issues because the courts have the authority to enforce the summons. However, utilizing the John Doe summons can bring the foreign nations to the table to negotiate as it did in the UBS case.[755] As Alfred Bender stated, the John Doe summons "*relies on using U.S. law as a means to coerce assistance from a foreign nation by exercising leverage over its citizens*".[756]

An interesting point to consider within this chapter is that the judicial approval limitation placed on the summons limits the effectiveness of this measure in obtaining information on taxpayers' foreign accounts. For example, if Congress had not passed the limitation in §7609(f), the IRS would have had almost limitless summons power. They would have been able to compel banks to disclose taxpayers' records and the third party, itself, has no interest in protecting those records which would leave the door wide open for the IRS to search through records looking for violations. So, while a broad discovery, fishing expedition style investigation through a John Doe summons would allow the IRS to potentially gather more information on U.S. taxpayers' foreign accounts, the first principles of justice[757] —

[754] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 297 (Spring 2013).
[755] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 297 (Spring 2013).
[756] Alfred Bender, *Domination v. Diplomacy: Comparing the Effectiveness of the United States' John Doe Summons with the United Kingdom's 2011 Tax Treaty with Switzerland*, 4 Geo. Mason J. Int'l Com. L. 286, 303 (Spring 2013).
[757] See footnote #614

as noted by the Supreme Court[758] — do not allow this. Therefore, the importance of the judicial approval limitation of 26 U.S.C. §7609(f) through the first principles of justice outweighs any small chance that the government would discover something through a fishing expedition style search through a taxpayer's records.

One way to ensure that the John Doe summons can obtain information is to do what is already being done – using other programs – like the FBAR and the voluntary disclosure programs – in conjunction with the John Doe summons.[759] Use those programs to procure the information and then target the groups of people identified using the information provided by complying taxpayers. But the nature of the John Doe summons – unknown taxpayers – makes it difficult to fill in the gaps because the IRS cannot know information that is not available to it unless they stumble onto it or it is discovered another way. If Congress provided for more funding for the IRS in the yearly appropriations bill, the IRS could (and should) hire more IRS agents to be able to enforce the tax laws. In the last decade, the IRS' funding has continued to decline[760] which is a strain on an already overburdened agency that is expected to reduce tax evasion among an American population of over 300 million people. There are already not enough agents to check each tax return which means that many returns that might be showing signs of tax evasion are being missed. Congress raises the issue of bringing home the tax revenue lost through tax evasion regularly, yet they are refusing to properly fund the agency that can ensure tax evaders are caught through evaluations of tax returns, tax audits and investigations. Understaffing and hindering the IRS will not help the U.S. government achieve their goal of procuring information on foreign accounts held by U.S. taxpayers.

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[758] *Federal Trade Commission vs. American Tobacco Co.*, 264 U.S. 298 (1924); *See also*, United States Federal Communications Commission, *Federal Communications Commission Reports: Decisions, Reports of the Federal Communication Commission of the United States*, Vol. 43, p. 1851 (April 24, 1953 to Oct. 1, 1954).

[759] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[760] Robert A. Weinberger, Tax Policy Center, *Budget Blues for Tax Administration, found at* https://www.taxpolicycenter.org/taxvox/budget-blues-tax-administration

The John Doe summons, while it can be an effective tool in gathering information on U.S. taxpayers' accounts foreign accounts, is also tricky because it is impossible to predict when information will be discovered that will allow a John Doe summons to be issued so that the IRS can gather information on those taxpayers' foreign accounts. The John Doe summons as an anti-tax evasion, information gathering measure cannot be used alone – it must be used in concert with other anti-tax evasion measures.

While this chapter was focused on using third parties to gather information on U.S. taxpayers' foreign accounts, the next chapter highlights an anti-tax evasion measure that utilizes foreign financial institutions to report U.S. taxpayers' information to the U.S. government through a program known as the Qualified Intermediary program.

CHAPTER 7. QUALIFIED INTERMEDIARY

7.1. INTRODUCTION

The Qualified Intermediary Program – another anti-tax evasion measure at the disposal of the Internal Revenue Service's disposal – is the focus of this chapter. In contrast to the previous chapter which focused on a procedural measure that allows the U.S. to attempt to gather information on U.S. taxpayers accounts abroad via third parties, this chapter's focus works with foreign financial institutions to procure information on U.S. taxpayer foreign accounts.

The beginning of the chapter introduces the Qualified Intermediary (hereinafter QI or QI program) program by reviewing the purpose and scope of this anti-tax evasion measure. Next, the chapter explains and analyzes how the QI program is implemented in order to enable the Internal Revenue Service (IRS) to obtain the information on U.S. taxpayers' foreign accounts. The chapter then reviews the problems that have presented themselves and how the U.S. government has attempted to solve these problems. Finally, the chapter then analyzes whether the QI program, as implemented, enables the IRS to procure the formerly inaccessible information. If the QI program does not allow the IRS to procure the information they seek, what can be done to improve this measure to increase the chances of obtaining the information?

It needs to be stated here that this chapter is inextricably linked with this thesis' Chapter 9, which covers Chapter 4 Withholding, which is a tax evasion deterrence system[761] that contains enhanced reporting requirements, and is the Foreign Account Tax Compliance Act or known colloquially as FATCA among the legal community in the U.S and worldwide. As stated in the delimitation, while FATCA and the QI program are linked and work together in complement to each other, only Chapter 3

[761] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).

(QI) withholding (which covers Non-Resident Alien "NRA" withholding) will be discussed here.

7.2. PURPOSE AND SCOPE OF THE QI REGULATIONS

The Qualified Intermediary program, created in 2000 through statutes and regulations, is another anti-tax evasion measure that the government created to force compliance by U.S. taxpayers who hold foreign accounts by enlisting the help of foreign financial institutions. This program allows the foreign financial institutions (hereinafter FFIs) to voluntarily report to the IRS any income earned and withholding taxes collected on U.S. source income on behalf of the United States.[762] The IRS' strategy in using the QI program was to enforce compliance with U.S. tax law – and more specifically – U.S. tax information reporting requirements by relying upon certain foreign

[762] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* (2009), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context ; *See also,* U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 3 (July 2008); GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS,* GAO-09-478T, 10 (March 2009); GAO, *Tax Compliance: Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Witheld and Reported, But Can Be Improved,* GAO-08-99, 9 (December 2007); IRS Announcement 2000-48, 2000-1 C.B. 1243; *See also,* William Byrnes & Robert J. Munro, *Background and Current Status of FATCA,* Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-9 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119; Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal*, JCS-4-09, 153 (Sept. 2009); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 153 (Palgrave MacMillian, 2016); Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Mark R. Van Heukelom, *The Foreign Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 101, 105 (Oct. 2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011)

intermediaries.[763] Initially, when considering the QI program, the IRS only wanted to certify businesses as a QI that were operating in a jurisdiction that had a bilateral tax treaty or Tax Information Exchange Agreement (TIEA), however, the taxpayers wanted the program to have as broad as scope as possible "*so that financial institutions can operate as qualified intermediaries in all jurisdictions in which they do business*."[764] From a business standpoint this makes sense to allow U.S. businesses to be able to compete internationally and be on equal footing with foreign corporations yet from the viewpoint of the IRS the ability for taxpayers to function in jurisdictions where there was no guarantee of the FFIs cooperation with the QI program was problematic as there would be no agreement with the government to enforce compliance with the QI.

One of the main purposes of the QI program was to create a system that established self-regulation standards for the FFIs while at the same time reducing the reporting requirements. This would make things easier for the FFIs while at the same time

[763] Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal*, JCS-4-09, 153 (Sept. 2009); *See also*, Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015); Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 358 (2010); Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of The U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 N.W. J. Int'l L. & Bus. 687 (Fall 2015); Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Mark R. Van Heukelom, *The Foreign Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. Corp. L. 101, 105 (Oct. 2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

[764] IRS Announcement 2000-48, 2000-1 C.B. 1243.

strengthening enforcement of the U.S. withholding system.[765] The IRS also noted that jurisdictions that refused to cooperate with the program and were considered tax havens or bank secrecy jurisdictions would have more stringent oversight over the FFI or branches of the FFI located in those jurisdictions.[766]

7.3. IMPLEMENTATION OF THE QI REGULATIONS

This next section will explain and analyze how the QI program is administered in order to allow the IRS to procure U.S. taxpayers' information on foreign accounts they hold.

The Qualified Intermediary Program is different from the other measures addressed in previous chapters in that it enlists FFIs to help in ensuring that U.S. taxpayers are complying with the tax laws of the United States.[767]

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[765] IRS Announcement 2000-48, 2000-1 C.B. 1243; *See also,* David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 184 (Palgrave MacMillian, 2016); GAO, *Tax Compliance: Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved*, GAO-08-99 (December 2007); Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 358 (2010); Marc M. Levey, *U.S. Taxation of Foreign Controlled Businesses*, ¶ 17.04 (Thomson Reuters Tax and Accounting, Nov. 2018); Marnin J. Michaels, *International Taxation: Withholding*, ¶ 4.03 (Thomson Reuters Tax and Accounting, September 2018); Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case*, 43 Cornell Int'l L.J. 409, 422-423 (2010).

[766] IRS Rev. Proc. 2017-15; *See also*, IRS Announcement 2000-48, 2000-1 C.B. 1243; Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

[767] Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

An income payment made outside the United States to a non-U.S. person (non-resident alien) is taxed in two ways.[768] First, if the income is considered business income and is connected with a U.S. business then this type of income is "*subject to a graduated tax rate as if the taxpayer is a U.S. citizen"*.[769] Second, if it is not considered U.S. business income, then it is taxed at a 30% flat rate.[770] This 30% tax rate can be reduced or eliminated via a tax treaty or another Internal Revenue Code exemption.[771] However, the 30% tax rate does not apply if it is discovered that the beneficial owner is actually a U.S. citizen.[772] This is because income paid to U.S. citizens abroad is subject to a separate reporting system entirely.[773]

Chapter 3, known as the "*QI regulations*" or "*1441 NRA*"[774], is the codification of the QI rules. The QI regulations are the tax withholding structure that gives relief at the source of taxation on U.S.-source income that is distributed minus the correctly withheld tax, paid to foreign persons and based on appropriate documentation of the beneficial owner.[775] Chapter 3 (of the Internal Revenue Code) outlines the rules so that FFIs can accurately assess and communicate any tax entitlements to those that need to withhold tax.[776] The subsequent sections examine and explain the Chapter 3 rules and the QI agreement. It is important to note here that the Chapter 3 rules and

[768] Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 359 (2010); *See also,* David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 153 (Palgrave MacMillian, 2016).
[769] 26 U.S.C. §871 (b); *See also,* Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 359 (2010).
[770] 26 U.S.C. §1441 (a); *See also,* 26 U.S.C. §871 (a); Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 359 (2010).
[771] 26 C.F.R. 1.1441-6 (a); *See also,* Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357, 3589(2010).
[772] 26 U.S.C. §1441 (c); *See also,* Steven Nathaniel Zane, *Carrot or Stick?: The Balance of Values in Qualified Intermediary Reform*, 33 B.C. Int'l & Comp. L. Rev. 357,359 (2010).
[773] 26 C.F.R. § 1.1441–1(c)(6); *See also,* 26 C.F.R. § 1.1441–1(b)(1)
[774] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 3 (Palgrave MacMillan 2013). NRA = Non-Resident Alien
[775] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 8 (Palgrave MacMillan 2013).
[776] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 8 (Palgrave MacMillan 2013).

the QI agreement are not one and the same. The QI agreement does not replace the requirements of Chapter 3 but, instead, adds additional obligations onto the QI FFI in exchange for additional benefits using the regulations as the starting point.[777] This will be explained in more detail further below.

7.3.1. CHAPTER 3 WITHHOLDING RESPONSIBILITY

One of the most important aspects of Chapter 3 that FFIs need to be aware of is that the moment that they receive a fixed, determinable, annual or periodic income payment sourced in the U.S. (hereinafter referred to as FDAP income/payment) they fall under this Chapter of U.S. tax law.[778] The FDAP income payment is the trigger and it is only the FDAP income that is the trigger and nothing else (i.e., trading in U.S. securities).[779] FDAP income is all gross income - for example, dividends, alimony and sales commissions paid monthly - under Chapter 61 of the IRC with the exception of gains derived from the sale of property or any other income that the IRS may determine does not qualify as FDAP income.[780]

There are two levels of intermediaries that this chapter is concerned with: the Qualified Intermediary and the Non-Qualified Intermediary (hereinafter referred to as QI and NQI, respectively).[781] An intermediary is a person that receives a payment and *"for that payment acts as a custodian, broker, nominee or otherwise as an agent for another person, regardless of whether such other person is the beneficial owner of*

[777] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2013).
[778] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 12 (Palgrave MacMillan 2013).
[779] 26 C.F.R. §1.1473-1(a)(2)(i)(A); *See* also, 26 C.F.R. §1.1441-2(b) & (c); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 12 (Palgrave MacMillan 2013); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 153 (Palgrave MacMillan 2016).
[780] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 14 (Palgrave MacMillan 2013).
[781] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 14 (Palgrave MacMillan 2013).

the amount paid, a flow-through entity or another intermediary".[782]The default status of all FFIs is as a non-qualified intermediary status.[783] A NQI is defined as "*any intermediary that is not a U.S. person and not a qualified intermediary…."*[784] Essentially, a NQI is a financial institution that is resident in a foreign country and has not signed a QI Agreement with the IRS.[785] A NQI has a different set of rules to follow, does not have a contract with the IRS (QI Agreement) and does not directly withhold the tax on payments as another FI in the chain will withhold – usually a U.S. withholding agent (USWA).[786] Despite not being required to withhold, the NQI still holds the responsibility and liability for correctly coordinating the withholding[787]. A NQI can apply for source relief, however, they will have to disclose and report on all of their customers to the IRS in addition to reporting to their upstream counterpart.[788] There are multiple reasons an FFI is not a QI: they make an affirmative choice not to be, they are not eligible because they are not located in a KYC-(Know-Your-Customer) approved jurisdiction (see subsection 7.3.1.2.1) or they are not aware they are subject to Chapter 3 regulations when they receive FDAP income payments.[789] The NQI is a cause of concern for the IRS (see subsection 7.3.1.5) because they are assumed to be assisting in the tax evasion when they do not want to share their customers information with the IRS. Therefore, the NQIs are held to stricter requirements under the regulations and why – if they want source relief – they must disclose all their clients to the IRS. This in turn, gets the IRS the information on their U.S. taxpayers' foreign accounts that they need to apply the laws fairly and correctly.

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[782] 26 C.F.R. §1.1441-1(c)(13).
[783] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 14 (Palgrave MacMillan 2013).
[784] 26 C.F.R. §1.1441-1(c)(14).
[785] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 15 (Palgrave MacMillan 2019).
[786] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 15 (Palgrave MacMillan 2013).
[787] 26 C.F.R. §1.1441-1 (e)(3)(iii)-(iv); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 15 (Palgrave MacMillan 2013).
[788] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 14 (Palgrave MacMillan 2013).
[789] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 15 (Palgrave MacMillan 2013).

In contrast, a FFI that signs a QI Agreement with the U.S. gets procedural leniency.[790] The Qualified Intermediary is subdivided into withholding QIs (WQIs) and non-withholding QIs (NWQIs).[791] A Withholding QI is responsible for both assessing and making a withholding on any gross income payment that they receive. This responsibility has been coined as "*assuming the primary withholding responsibility*" in the regulations.[792] They are also responsible for making deposits with the U.S. Department of Treasury.[793] A note to insert here is that there is a difference in the roles that the IRS and the U.S. Department of Treasury have despite the IRS being a sub-agency under the Treasury. The U.S. Treasury receives the money, in this case, the deposits of withheld tax. The IRS drafts and communicates the regulations in addition to receiving reports from the QIs and NQIs.[794]

The subsequent sections will delve into the QI Agreement and the requirements of Chapter 3 in more detail.

7.3.1.1 QI Agreement

The QI Agreement, as stated previously, is an agreement that dovetails with the QI regulations in that it outlines all the obligations that the QI has under Chapter 3 along with some additional obligations in exchange for certain benefits. [795] The Agreement, the most current version which can be found in Revenue Procedure 2017-15, is

[790] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 115 (Palgrave MacMillan 2013).
[791] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 12 (Palgrave MacMillan 2013).
[792] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 15 (Palgrave MacMillan 2013).
[793] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 12 (Palgrave MacMillan 2013).
[794] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 17 (Palgrave MacMillan 2013).
[795] 26 C.F.R. §1.1441-1(e)(5)-(6); *See also*, 26 U.S.C. §1441, §1442, §1471 and §1472; IRS Rev. Proc. 2017-15; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 25 (Palgrave MacMillan 2013).

regulated by 26 C.F.R. §1.1441-1(5)(e)(iii).[796] The QI agreement is a non-negotiable contract between the IRS and the FFI that runs over a six-year period and is unilaterally modifiable only by the IRS.[797] The following subsections will examine the three areas of the QI Agreement that describe the main responsibilities and obligations of the QI under the Agreement. These three subsections are: 1) withholding, 2) documentation and disclosure and 3) tax return and information reporting.

A foreign intermediary who wants to be a QI has to be eligible to qualify as a QI – not just any FFI that wants to be a QI can be.[798] In order to be approved as a QI, the QI has to be an asset manager/servicer such as a bank or broker and is regulated by rules – particularly Know Your Customer (hereinafter KYC) rules – in their home country.[799] Under the QI Agreement, there are two categories of QIs: withholding QIs (WQI) or non-withholding QIs (NWQI).[800] The Agreement that the QI executes identifies the QI as a withholding agent under Chapter 3 as well as a payor under Chapter 61 and 26 U.S.C. §3406 of the Internal Revenue Code. However, the QI can elect to be a NWQI which means the tax will be withheld up the chain usually by a United States Withholding Agent (USWA). An NWQI that selects this option still has the same obligations under the agreement as a QI and it still retains the liability for tax withheld.[801] Despite outsourcing its withholding responsibilities, it is still responsible for arranging for a third party to take on the withholding.[802] If an under-

[796] IRS Rev. Proc. 2017-15 (updates IRS Revenue Procedure 2000-12 (2000-4-IRB 387); *See also*, 26 C.F.R. §1.1441-1(e)(5)(iii); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 11-12 (Palgrave MacMillan 2013).
[797] IRS Rev. Proc. 2017-15, Section 6, 11.01; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 25 (Palgrave MacMillan 2013).
[798] 26 C.F.R. §1.1441-1(e)(6)(ii); *See* also, 26 C.F.R. 1.1441-1(e)(5)(ii); IRS Rev. Proc. 2017-15, Section 2; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 27 (Palgrave MacMillan 2013).
[799] 26 C.F.R. §1.1441-1(e)(5)(ii); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 27 (Palgrave MacMillan 2013).
[800] 26 C.F.R. §1.1441-1.
[801] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[802] IRS Rev. Proc. 2017-15; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2019).

withholding occurs higher up the chain, the NWQI is required to withhold the balance of the correct withholding so that the beneficial owner of the account receives the payment less the amount of the withholding.[803]

The QI that decides to assume primary withholding responsibility does not have to accept on behalf of all accounts.[804] It can select the accounts that it wants to be a withholding agent for – it can be one, a few or all. This account designation is important and has important ramifications for the QI.[805] The withholding section of the QI agreement also requires the QI to backup-withhold on undocumented U.S. accounts.[806] This is to ensure that there is a withholding on these types of accounts.

The Agreement requires, under Chapter 3, that the QI documents all their clients using their KYC rules and/or with U.S. withholding certificates such as the IRS W-8 and W-9 forms.[807] The W-8BEN form is the Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding and Reporting (Individual) but there are multiple versions of the W-8 form depending on what category the foreign person falls in (i.e., foreign entity, foreign government, etc.).[808] For example, the W-8IMY form is the withholding certificate used by foreign intermediaries to identify themselves as foreign intermediaries (or foreign flow-through entities) to others in the chain including the USWA.[809] The QI needs to verify that it is using the correct W-8 form. The W-9 form is titled Request for Taxpayer Identification Number and Certification and is used for identifying and withholding on U.S. citizens.[810]

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[803] IRS Rev. Proc. 2017-15; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28 (Palgrave MacMillan 2019).
[804] 26 C.F.R. §1.1441-1(e)(5)(iv); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 27 (Palgrave MacMillan 2013).
[805] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28 (Palgrave MacMillan 2013).
[806] 26 C.F.R. §1.1441-1(e)(5); *See also*, IRS Rev. Proc. 2017-15.
[807] 26 C.F.R. §1.1441-1(b)(vii); *See also*, IRS Rev. Proc. 2017-15; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 11-12 (Palgrave MacMillan 2013).
[808] IRS, Form W-8, https://www.irs.gov/forms-pubs/about-form-w-8
[809] IRS, Form W-8IMY, https://www.irs.gov/forms-pubs/about-form-w-8-imy
[810] IRS, Form W-9, https://www.irs.gov/forms-pubs/about-form-w-9

What happens if the QI has actual knowledge that documentation is incorrect, false or unreliable? If the QI has reason to know (or actual knowledge) that documentation that has been submitted to them is false, erroneous or inaccurate, then the QI cannot rely upon the documentation as proof of identity.[811] This includes changes of circumstance.[812]

The QI has various documentation obligations under the QI Agreement and these reflect the Chapter 3 regulations.[813] One obligation the QI has is to document its customers and review and validate that documentation.[814] The QI is required to use their best efforts to obtain all documents required under the QI Agreement using the forms under the KYC procedures or the documents discussed in the above paragraph.[815] Once the QI has the appropriate forms, they are required to review, validate and track the validation of the documents they obtain.[816] If the account holder is NOT an individual, then the QI has an obligation to inform the account holder of any Limitation on Benefits (LOB) clauses in the applicable treaty with the U.S. and obtain a treaty statement from the account holder.[817] The treaty statement is just a statement that states that an entity client – including governmental entities – meets all the provisions of the applicable treaty and, therefore, qualifies for a reduced rate of

[811] 26 C.F.R. §1.1441-1(b)(3)(ix); *See also*¸ 26 C.F.R. §1.1441-7(b)(1)-(2); IRS Rev. Proc. 2017-15, Section 6, 5.10; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 26 (Palgrave MacMillan 2013).
[812] 26 C.F.R. §1.1441-7(b)(1)-(2); IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01-5.12; *See also,* Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[813] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01-5.12; *See also,* Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[814] 26 C.F.R. §1.1441-1(e)(5); *See also*, IRS Rev. Proc. 2017-15, Section 6, 5.01-5.12; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[815] 26 C.F.R. §1.1441-1(e)(5); *See also*, IRS Rev. Proc. 2017-15, Section 6, Subsection 5.03; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 35 (Palgrave MacMillan 2013).
[816] 26 C.F.R. §1.1441-1(e)(5); *See* also, IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01(A); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 35 (Palgrave MacMillan 2013).
[817] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01(A); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 35 (Palgrave MacMillan 2013).

withholding (including limitation on benefits provisions).[818] The QI Agreement provides the treaty statement under subsection 5.03(B).[819] The documentation the QI is required to obtain helps in determining whether withholding (discussed in section 7.3.1.4) applies or whether a payment is reportable under the QI Agreement.[820] A reportable payment is defined as reportable amount which "*means U.S. source FDAP income that is an amount subject to chapter 3 withholding, U.S. source deposit interest*…"[821]

This is where both the KYC rules (see subsection 7.3.1.2.1) and the "*reason to know*" standard apply (see subsection 7.3.1.2.4).[822] If there is no documentation, then the QI is obligated to apply a set of presumption rules.[823] The presumption rules, found in section 5.13 of the Agreement, are applied in order to determine if Chapters 3 and 4 withholding or backup-withholding (in the case of a possible U.S. person) is required.[824] The QI agreement identifies the KYC rules as the applicable laws, regulations, rules and administrative procedures that govern the QI (in their home jurisdiction) and requires the QI to obtain documentation that confirms the identity of the account holders that maintain accounts with the QI.[825] This qualification does not apply to Non-Financial Foreign Entities (hereinafter referred to as NFFE's) and their branches because they are required to document and identify their account holders by collecting withholding certificates.[826] An NFFE is defined as a foreign entity that is not a financial institution.[827]

[818] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.03(B).
[819] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.03(B).
[820] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01(A).
[821] IRS. Rev. Proc. 2017-15, Section 6, Subsection 2.69 and 2.68.
[822] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[823] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 28 (Palgrave MacMillan 2013).
[824] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01(A).
[825] IRS Rev. Proc. 2017-15, Section 6, Subsection 2.45.
[826] IRS Rev. Proc. 2017-15, Section 3.
[827] 26 C.F.R. §1.1441-1(c)(51); *See also,* 26 C.F.R. §1.1441-1(e)(5)(ii); 26 C.F.R. §1.1471-1(b).

The point of requiring this documentation through the use of both the KYC and presumption rules is to ensure that U.S. taxpayers are being identified and properly withheld on correctly. If an accountholder is not correctly identified through documentation, then the proper tax cannot be withheld and paid to the Treasury. It also means that U.S. taxpayers are not being correctly identified so that the IRS can access the information they are seeking on any foreign accounts held by the U.S. taxpayers.

Any taxes that are collected by the QI are to be deposited with the U.S. Treasury. They are also obligated to have two compliance reviews during the six-year contract period. This is part of the oversight of the QIs and is specific to only those FFIs that have signed a QI Agreement.

The main difference between a financial institution that signs a QI and one that does not (NQI), is that the QI Agreement applies different rules to the QI and its activities. The most important benefits that the QI derives from the Agreement that the NQI does not qualify for are the ability to protect its foreign beneficial owners' identities, the ability to provide source relief on U.S.-source FDAP income payments and the ability to pool its information returns that it sends to the IRS.[828]

It is critical and necessary to reiterate here that a NQI who either chooses not to be a QI or who is not eligible still falls under the Chapter 3 requirements if they receive FDAP income.[829] They are still subject to the reporting and enforcement components of the regulations but do not receive the special benefits that a QI does.[830] The NQI can still receive relief at the source, but only if they are willing to disclose in its entirety the information on who their customers are to another QI or USWA up the

[828] IRS Rev. Proc. 2017-15; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
[829] IRS Rev. Proc. 2017-15; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
[830] IRS Rev. Proc. 2017-15; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).

chain.[831] The reason for the distinction is that the NQIs have not signed a QI agreement with the IRS (so they are not under contract with the IRS) and, therefore, the IRS has no direct control over the NQIs compliance with the QI program rules. [832] The NQIs are suspected of being more susceptible to tax evasion and, thus, are required by the U.S. to divulge all accountholders to the U.S. individually.[833]

7.3.1.2 Documentation

This section focuses on the Chapter 3 regulations regarding documentation on the FFIs clients. Documentation is the core of the Chapter 3 regulations because it leads to the rest of the main requirements – reporting and withholding.[834] The regulations, focused on deterring tax evasion (and treaty shopping) by U.S. taxpayers, require the FFIs to document all their customers - not just the U.S. customers - in order to fulfill deterrence purpose.[835] Ross McGill notes that the Chapter 3 regulations are a cascade system meaning that "*there are obligations at all levels and that non-compliance at any level is automatically visible to the IRS through compliance at the higher level, usually through information reporting*."[836] But documentation is important in another regard. Documentation (and identification), if done correctly,

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[831]; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
[832]; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 11 (Palgrave MacMillan 2019).
[833] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 11 (Palgrave MacMillan 2019).
[834] *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).
[835] *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).
[836] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 2 (Palgrave MacMillan 2013).

of U.S. taxpayers leads to the information that the U.S. government needs in order to administer the tax laws fairly and correctly.

The FFIs have to provide self-certifications to the party upstream from them where they hold accounts that possibly receive U.S.-sourced FDAP income.[837] Not only does each party self-certify, but they also must document all their customers. It is a page out of the small-town playbook – everyone knows everyone else and their business (meaning here the identification and obligations of each of the other parties).

The purpose of the documentation procedure is to determine:

1) the identity of the account holder;
2) whether the account holder is a beneficial owner or intermediary;
3) the country where it resides for tax purposes;
4) whether it is U.S. person or a non-U.S. person; and
5) whether the account holder is entitled to any favorable rate of tax on U.S.-sourced income.[838]

If the FFI documents correctly, this allows the IRS to receive the information on U.S. taxpayers and their foreign accounts. Subsection 7.3.1.2.3 discusses documentation and documentary evidence in more detail.

[837] 26 C.F.R. §1.1441-1; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).
[838] 26 C.F.R. §1.1441-1; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 28-29 (Palgrave MacMillan 2013).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).

7.3.1.2.1 Self-certification and KYC Rules

There are two ways for FFIs to fulfill their documentation obligation: self-certification and KYC rules.[839] The documentation provided will give the FFIs (QIs and NQIs) the information needed in order for the FFIs to correctly withhold on U.S-sourced income payments.[840] An FFI needs to know what qualifies as documentation to ensure that they meet the requirements. Documents other than the withholding certificates or written statements are considered documentary evidence.[841] An example of documentary evidence would be the KYC documents.[842] Documentation includes documentary evidence and the W-8 withholding certificates.[843]

The first type of documentation comes in the form of self-certifying documents such as the U.S. W-8 or W-9 tax forms. A self-certification is not the same as a residence certification which is issued by a tax or governmental agency at the request of a resident; in contrast, the self-certifications are filled out by the resident/account holder themselves.[844] Starting from the bottom of the chain, the beneficial owner of the payment should submit either a W-8 or a W-9 depending on their U.S. status. If the beneficial owner is a U.S person they would file a W-9 which is also known as a Request for Taxpayer Identification Number[845] and Certification.[846] The FFIs

[839] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 34 (Palgrave MacMillan 2013).
[840] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).
[841] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).
[842] 26 C.F.R. §1.1441-1; *See also*, 26 C.F.R. §1.6049-5(c)(1); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).
[843] 26 C.F.R. §1.1441-1; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).
[844] 26 C.F.R. §1.1441-1; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 35 (Palgrave MacMillan 2013).
[845] This is usually the taxpayer's social security number but if it's a foreign resident alien or non-resident alien, then it is ITIN (individual taxpayer identification number).
[846] IRS, *About Form W-9*, https://www.irs.gov/forms-pubs/about-form-w-9; *See also*, https://www.irs.gov/pub/irs-pdf/fw9.pdf; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).

themselves, would provide a W-8IMY – which is the version of the W-8 for foreign intermediaries for U.S. tax withholding and reporting – to either another FFI upstream from them or a USWA.[847]

FFIs are allowed to rely on these self-certifications unless they have actual knowledge or "*reason to know*" that the self-certification is incorrect or false.[848] If there is no reason to know and then the FFI discovers later that the tax was withheld incorrectly, they will not be held strictly liable since they made the determination of the appropriate amount of tax to withhold based on the self-certification provided by the account holder.[849] The FFI does have an obligation to verify that a self-certification form is consistent with other documentation/information that the FFI received, for example, documents obtained under the KYC procedures.[850]

The second way an FFI can certify the identity of a person or entity is through KYC rules.[851] KYC procedures are domestically approved local rules that are used by the FFI to identify and "*know*" their customers. The IRS relies on the knowledge that if the FFI meets the KYC regulations that are in place in their own jurisdiction then they are also meeting them for Chapter 3 purposes. This is because the IRS believes that in order for a foreign financial institution to adequately self-regulate under the QI program appropriate KYC rules are needed.[852] If the FFI has been accepted by the IRS as a QI, then the FFI is in a jurisdiction whose KYC rules have already been approved.[853] The KYC approved list can be found on the IRS website.[854] The IRS' KYC list identifies the countries that have provided their KYC practices and

[847] IRS, *About Form W-8IMY*, https://www.irs.gov/forms-pubs/about-form-w-8-imy; *See also*, https://www.irs.gov/pub/irs-pdf/fw8imy.pdf; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 33 (Palgrave MacMillan 2013).
[848] 26 C.F.R. §1.1441-1(e)(1)(i); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[849] 26 C.F.R. §1.1441-1(b)(3)(ix).
[850] 26 C.F.R. §1.1441-7(b)(7).
[851] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 34 (Palgrave MacMillan 2013).
[852] IRS Announcement 2000-48, 2000-1 C.B. 1243.
[853] IRS Announcement 2000-48, 2000-1 C.B. 1243.
[854] IRS, *List of Approved KYC Rules*, https://www.irs.gov/businesses/international-businesses/list-of-approved-kyc-rules.

procedures to the IRS who then examines the rules to ensure they are acceptable.[855] Multiple EU countries are on the list including Denmark, Germany and the U.K.[856] Having the KYC rules in place ensures verification and documentation of beneficial owners[857] and the target is to identify and withhold the correct amount of tax on the beneficial owner based on the verification and documentation.

7.3.1.2.2 U.S. Indicia

An issue with both the forms and KYC documents is whether there is any indication of taxpayer's U.S. status. This is referred to as "*indicia of U.S. status*" which is "*the presence of any information that might indicate U.S status for tax purposes*".[858] The differences in Chapters 3 (QI) and 4 (FATCA) is that in Chapter 3, the indications are based on information from the KYC procedures and the W-8 forms and in Chapter 4, the indicia is more narrowly defined.[859] If the account has a U.S. address attached to it, this is the main piece of identification that should alert the FFI to U.S. indicia.[860] This means the FFI has to do more legwork to establish if the foreign person has a credible reason for the address or if the account holder is an actual U.S. person. While the FFI does the legwork to establish the actual status of the account holder, the status of the form in question will be on hold until the issue is resolved by more documentation.[861] If the account holder is an individual, then the additional documentation must establish that the account holder's residency is outside the

[855] IRS, *List of Approved KYC Rules*, https://www.irs.gov/businesses/international-businesses/list-of-approved-kyc-rules; *See also*, IRS Announcement 2000-48, 2000-1 C.B. 1243.
[856] IRS, *List of Approved KYC Rules*, https://www.irs.gov/businesses/international-businesses/list-of-approved-kyc-rules
[857] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 186 (Palgrave MacMillian, 2016).
[858] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).
[859] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[860] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[861] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).

United States and that the documentation was valid when provided and is not older than three years.[862] The additional documentation should also establish either that it does not contain a U.S. address or provide a reasonable explanation of why there is a U.S. address attached to the account.[863]

If the account holder is an entity, then the additional documentation must establish that the entity is actually organized/created under the laws of a non-U.S. country.[864]

The FFI has to obtain valid documentation from the downstream parties (including the beneficial owner) just as it has to provide documentation upstream to a financial institution where it maintains an account.[865] Ross McGill points out that obtaining documents under the KYC procedures generally is not a problem because it is "generally culturally and linguistically aligned".[866] The same cannot be said, however, for U.S. forms.[867] This is a problem because a high percentage of W-8BEN forms are invalid when received because those who obtain the forms are not tax experts or lawyers nor are they, many times, familiar with the U.S. tax language.[868] This problem presents an obstacle to the goal of the U.S. government in ensuring they are able to obtain information on U.S. taxpayers' foreign accounts. If the forms are filled out incorrectly then the withholding (law) is not withheld properly and the correct information on the taxpayer's account – if they are a U.S. person – is not

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[862] 26 C.F.R. §1.1441-1(c)(17); *See also*, 26 C.F.R. §1.6049-5(c)(1); 26 C.F.R. §1.1471-3(c)(5)(i)(A) – (B); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).
[863] 26 C.F.R. §1.1441-1(c)(17); *See also*, 26 C.F.R. §1.6049-5(c)(1); 26 C.F.R. §1.1471-3(c)(5)(i)(A) – (B); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).
[864] 26 C.F.R. §1.1441-1(c)(17); *See also*, 26 C.F.R. §1.6049-5(c)(1); 26 C.F.R. §1.1471-3(c)(5)(i)(D) & (ii)(A).
Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).
[865] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[866] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[867] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[868] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).

given to the IRS. "…*important to realise that the documentation drives withholding and withholding must be correct*."[869]

Another issue that is problematic is that many of the tax forms that are obtained are handwritten which presents the cultural and linguistic problems alluded to above and the FFIs have to validate these handwritten forms.[870] These issues present a perfect storm, so to speak, regarding the documentation process.[871]

There are two avenues to avoid this perfect storm[872]: substitute forms and systems to fill out forms electronically.[873] Substitute forms and electronic systems are allowed under 26 C.F.R. §1.1441-1(e)(4)(iv) through (vi).[874] A withholding agent is allowed to establish an electronic system for a beneficial owner or a payee to be able fill out a W-8 form or a substitute form as long as it fulfills the criteria under the regulations[875]. The electronic system should be able to ensure that the information that is obtained is the information that is sent and be able to document every time a user accesses the system in order to modify the document or for submission renewal.[876] The system also has to have a way to make it "reasonably certain" that the person using the system and submitting the W-8 form is the actual person named in the form. The electronic form should contain the exact same information as the paper form of the W-8.[877] The regulations also allow for the withholding agent to be able to accept a substitute of its own instead of a W-8 form.[878] The IRS will find that

[869] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* (Palgrave MacMillan 2019).
[870] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
[871] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
[872] See subsection 7.6 for more discussion on the substitute forms and electronic systems being a solution to cultural and linguistic issues.
[873] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
[874] 26 C.F.R. §1.1441-1(e)(4)(iv) - (vi); *See also*¸ Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
[875] 26 C.F.R. §1.1441-1(e)(4)(iv)(A)-(B).
[876] 26 C.F.R. §1.1441-1(e)(4)(iv)(A)-(B).
[877] 26 C.F.R. §1.1441-1(e)(4)(iv)(A)-(B).
[878] 26 C.F.R. §1.1441-1(e)(4)(vi).

the substitute form is acceptable as long as the provisions are substantially similar to those provisions that are found on the official W-8 form.[879] It should also contain *"the same certifications relevant to the transactions as are contained on the official form and these certifications are clearly set forth, and the substitute form includes a signature-under-penalties-of-perjury statement identical to the one stated on the official form"*.[880] For example, providing a translation of the U.S. form into the account holder's language so that the account holder has both the U.S. form and the translation side-by-side.[881] Legally speaking, the English forms are always the form with legal force and this should be made clear to the account holder.[882]

7.3.1.2.3 Documentation and Documentary Evidence[883]

So, what documents does an FFI use to evidence whether an account holder is an American or a foreigner? There are two places to find the documentation and documentary evidence obligations: the regulations from Chapter 3 or the contractual obligation between the FFI and the IRS under the QI Agreement (for the discussion on the documentation obligations under the QI Agreement, see the immediate previous section).[884] This means that despite not being a QI under the QI agreement, the NQIs are still held accountable to documentation obligations under Chapter 3 and QIs are subject to both the regulations and the QI agreement.[885] When the documentation is done correctly, compliance with the regulations and QI Agreement have been achieved and allows for correct withholding and reporting which also

[879] 26 C.F.R. §1.1441-1(e)(4)(vi).
[880] 26 C.F.R. §1.1441-1(e)(4)(vi).
[881] 26 C.F.R. §1.1441-1(e)(4)(vi); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[882] 26 C.F.R. §1.1441-1(e)(4)(vi); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).
[883] 26 C.F.R. §1.1441-7(b)(7)-(8).
[884] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 36 (Palgrave MacMillan 2013).
[885] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 37 (Palgrave MacMillan 2013).

complies with U.S. laws.[886] Compliance also allows the IRS to have information on U.S. taxpayers' foreign accounts.

What qualifies as documentation? For an individual, it is both the appropriate withholding certificate[887] (W-9 versus W-8) and documentary evidence[888] such as an official document that is issued by a non-U.S. government entity. This documentation should include the individual's name, address and a photo and the document cannot be older than three years unless accompanied by additional documentation of residence – for example, a utility or phone bill.[889]

A withholding certificate is a document that the QI has to furnish to a withholding agent that it receives a reportable amount from.[890] The Qualified Intermediary Withholding Certificate is Form W-8IMY which certifies that the QI is acting as a QI.[891] It also contains the QI's QI-EIN (the employer identification number given to the QI by the IRS) and the other information that the form itself requires.[892] The FFI is required to provide each withholding agent that receives a Form W-8IMY from the FFI the withholding statement.[893] The FFI is not required to disclose on either Form W-8IMY or the withholding statement any identifying information about a foreign indirect or direct account holder.[894] This also applies to a U.S- exempt recipient or holder of a U.S. account.[895] The other forms that a FFI can give to the withholding agent to identify who the account holder is, is either a W-9[896] which

[886] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 39 (Palgrave MacMillan 2013).
[887] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[888] 26 C.F.R. §1.1441-7(b)(7)-(8).
[889] 26 C.F.R. §1.1441-7(b)(7)-(8).
[890] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[891] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[892] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[893] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[894] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[895] 26 C.F.R. §1.1441-7(b)(5)(i)-(ii).
[896] 26 C.F.R. §1.1441-1(d)(1)-(3).

identifies them as a U.S. person or a version of the W-8 forms[897] which identifies them as a non-U.S. person.[898]

W-8 and W-9 forms are not included as documentary evidence (discussed below) to prove an account holder's status.[899] If the FFI cannot accurately associate a reportable payment with valid documentation from the account holder, then the FFI has to apply the presumption rules in order to determine if Chapters 3 and 4 withholding or backup withholding (under 26 U.S.C. §3406) are required.[900] The presumption rules are rules that "*apply to determine the status of the person you pay as a U.S. or foreign person and other relevant characteristics, such as whether the payee is a beneficial owner or intermediary…..*"[901]

Documentary evidence and other appropriate documentation is documentation other than the withholding certificate as described in the last sentence.[902] Supplementary documentation is a passport, certificate of residency provided by a government agency, national identity card or a voter registration card.[903] For an entity, the documentation should be an official document that provides the name and main address of the entity that has been issued by a non-U.S. government agency.[904] Supplementary documentation for an entity can include the articles of incorporation,

[897] 26 C.F.R. §1.1441-1(e)-
[898] IRS, Form W-8, https://www.irs.gov/forms-pubs/about-form-w-8; IRS, Form W-9, https://www.irs.gov/forms-pubs/about-form-w-9
[899] IRS Rev. Proc. 2017-15, Section 6, Subsection 2.20.
[900] 26 C.F.R. §1.1441-1(b)(3); 26 C.F.R. §1.1441-1(b)(2)(vii).
[901] IRS, *Presumption Rules*, *found at* https://www.irs.gov/individuals/international-taxpayers/presumption-rules
[902] 26 C.F.R. §1.1441-7(b)(7)-(8); *See* also, 26 C.F.R. §1.1441-1(c)(17) and (18); *See also*, 26. CF.R. §1.1471-3(c)(32) and (33).
[903] 26 C.F.R. §1.1441-1(c)(17) and (18); *See also*, 26 C.F.R. §1.1471-3(c)(32) and (33); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 52 (Palgrave MacMillan 2013).
[904] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 53 (Palgrave MacMillan 2013).

articles of association, or trust documents.[905] Most of the above examples will have already been on file with the FFI due to their own jurisdiction's KYC procedures.[906]

After receiving the documentation, the next step for the FFI (QI and NQI) is to review the documentation and to validate it. The FFI has an obligation under Chapter 3, to review and validate the forms that they obtained from the account holder.[907]

So, what does this review and validation part of the process look like? Once the recipient receives the documentation, it should be evaluated for four elements according to Ross McGill.[908] The first element that the documentation should be evaluated for is that the documents are complete.[909] All parts of the documents should be filled out[910] and the form should be signed if there is a place for a signature. The next item to evaluate is whether the documentation itself is consistent internally. This means that any information contained within the form should be consistent with the other information in the same document. If something is found to inconsistent, clarification should be sought.[911] Third, the documentation should also be externally consistent.[912] The information that is within the documentation received should match any information that is at the disposal of the FFI – for

[905] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 53 (Palgrave MacMillan 2013).
[906] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 53 (Palgrave MacMillan 2013).
[907] 26 C.F.R. §1.1441-1(e)(2); *See also*, IRS Rev. Proc. 2017-15, Section 6, Subsection 5.01(A); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).
[908] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).
[909] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).
[910] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).
[911] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).
[912] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 39 (Palgrave MacMillan 2013).

example, through KYC procedures.[913] Finally, the documentation should be examined for any U.S. indicia.[914] For instance, does the documentation provide a U.S. social security number or does it list a U.S. address? If so, a deeper look should be taken into why the account holder has a U.S. address or social security number. It should be determined if the account holder is a U.S. or foreign person. If any one of these elements is deemed insufficient, then the information that has been given should be clarified or if not able to be clarified, the documentation can be rejected.[915] If the FFI takes a deeper dive into the information, any work that is done in order to clear up any questions should be clearly and carefully documented.[916]

If the FFI cannot reasonably associate a payment with valid documentation from an account holder, then they have to apply the presumption rules .[917] The presumption rules state that if the withholding agent cannot reliably associate a payment with documentation, the presumption will be made that the account holder is a U.S. person and the account will be treated as a U.S. account.[918] When the presumption rules are required to be applied, the FFI cannot rely on its actual knowledge regarding an account holder's Chapter 4 status or status as U.S. or foreign person to apply a reduced rate of withholding. If a FFI does not follow the presumption rules, the FFI may liable for under-withholding, penalties and interest.[919]

[913] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 39 (Palgrave MacMillan 2013).
[914] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 39 (Palgrave MacMillan 2013).
[915] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 39 (Palgrave MacMillan 2013).
[916] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 40 (Palgrave MacMillan 2013).
[917] 26 C.F.R. §1.1441-1(b)(3)(i)-(iii); *See also,* IRS Rev. Proc. 2017-15, Section 6, Subsection 5.13(A).
[918] 26 C.F.R. §1.1441-1(b)(3)(iii); *See also,* IRS Rev. Proc. 2017-15, Section 6, Subsection 5.13(A).
[919] 26 C.F.R. §1.1441-1(b)(7).

Until the documentation is clarified and complete, the beneficial owner should be treated as undocumented and taxed at 30% or the FFI can apply the presumption rules found in the regulations as stated above.[920]

The FFI has a duty to maintain documentation by retaining the original documentation. The FFI may also retain a certified copy, photocopy, scanned copy, microfiche copy or other ways that allow reproduction but the FFI has to be able to produce a hard copy.[921] Due to the nature of the direct relationship and the KYC rules that are supposed to be in place in regards to direct accounts, if the FFI is not required, under its KYC procedures, to retain copies of documentary evidence, the FFI may instead retain an notation of the type of document reviewed, the date it was reviewed, the documentation's identification number and whether the documentation reviewed contained any U.S. indicators.[922] The FFI is required to maintain a record of the account holder's documentation for as long as the documentation is relevant to determining the FFI's tax liability or reporting responsibilities.[923]

A natural question to ask is how long is the documentation and documentary evidence valid? How long the documentation is valid depends on whether it is a W-9 form or not.[924] If the documentation is any type of documentation other than a W-9, the FFI may rely on it in accordance with the KYC rules that are applicable as long as the documentary evidence remains valid under those rules or until the FFI has knowledge or reason to know that the information in the documentation is incorrect or unreliable.[925] If the documentation is a W-9 form, then the FFI can rely on it as long

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[920] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 40 (Palgrave MacMillan 2013).
[921] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.12(A); *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[6][b][i] (Thomson Reuters/WG&L).
[922] 26 C.F.R. §1.1441-1(e)(4)(iii).
[923] 26 C.F.R. §1.1441-1(e)(4)(iii); *See also*, 26 U.SC. §871, 26 U.S.C. §881, 26 U.S.C. §1461, 26 U.S.C. §1474(a) and 26 U.S.C. §3406.
[924] 26 C.F.R. §1.1441-1(e)(2)(ii)(A); *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[6] (Thomson Reuters/WG&L).
[925] IRS Rev. Proc. 2017-15, Section 6, Subsection 5.11(A); *See also*, Marnin J. Michaels, International Taxation: Withholding, ¶4.03[6][b][ii] (Thomson Reuters/WG&L).

as it has not been informed by either the IRS or another withholding agent that the information is incorrect or unreliable.[926]

7.3.1.2.4 Reason to Know and Actual Knowledge[927]

Two concepts that are important both with the QI Program and the Foreign Account Tax Compliance Act (FATCA, see subsection 9.3.1.1.4) are the standards of "*reason to know*" and "*actual knowledge*".[928] These concepts are particularly important for those in the position of relationship managers in the FFIs.[929] Under the regulations, the withholding agent may rely on the information and certifications stated in the withholding certifications (discussed in the next section) unless the agent (or relationship manager) has reason to know or actual knowledge that the information is incorrect.[930] Actual knowledge is defined as "*direct and clear knowledge*" or knowledge that would lead a reasonable person to inquire further.[931] Reason to know is defined as "*information from which an person of ordinary intelligence – or of the superior intelligence that the person may have – would infer that the fact in question exists or that there is substantial enough chance of its existence that, that if the person is exercising reasonable care, the person's action would be based on the assumption of its possible existence*."[932] For example, if the account holder, who is documented by the FFI as a non-US person, goes into the bank to talk with the relationship manager about the account and her U.S. passport falls out of her purse

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926 IRS Rev. Proc. 2017-15, Section 6, Subsection 5.11(B); *See also*, Marnin J. Michaels, International Taxation: Withholding, ¶4.03[6][b][ii] (Thomson Reuters/WG&L).
927 26 C.F.R. §1.1441-7(b)(1)-(2) & (4).
928 26 C.F.R. §1.1441-7(b)(1)-(2) & (4); *See also*, 26 C.F.R. §1.441-1(e)(4)(viii); *See also*, 26 C.F.R. §1.1441-1(b)(3)(ix)(B).
929 Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
930 26 C.F.R. §1.441-1(e)(4)(viii); *See also*, 26 C.F.R. §1.1441-1(b)(3)(ix)(B). Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 37 (Palgrave MacMillan 2013).
931 Black's Law Dictionary, 7th edition, 876 (Bryan A. Garner, ed., 1999).
932 Black's Law Dictionary, 7th ed., 1273 (Bryan A. Garner, ed., 1999).

onto the desk, the relationship would have actual knowledge that the account holder is a U.S. citizen/taxpayer. However, if the account holder instead mentions an upcoming trip to the U.S to see her mother, the relationship manager has been given reason to know and should take a deeper look into the account holder's status.

The reason to know and actual knowledge concepts is one place where Chapter 3 (QI) and Chapter 4 (Foreign Account Tax Compliance Act/FATCA - Chapter 9) converge.

As far as documentation goes – under Chapter 3 – the most important things to remember for both a QI and NQI are that everyone must document themselves to those FFIs (or USWAs) above them in the chain, that the documentation obligations can be found in the U.S Code of Regulations (Code of Federal Regulations, Chapter 26 for tax regs) and the QI Agreement for accepted QIs and that both the QIs and NQIs have the obligation to review and validate the forms that they receive.

7.3.1.3 Withholding[933] and Depositing Tax[934]

The process of documentation and identification allows the FFIs to process the income payments which includes knowing if the payment is subject to withholding, and if so, how much.[935] The FFI must have the information from the documentation stage, in order to help either themselves (if they have taken on primary withholding responsibility) or another withholding agent up the chain know how to process the income payment.[936] At the top of the food chain is the U.S. withholding agent (USWA), but if the FFI assumes primary withholding responsibility then it becomes the one to determine whether the payment is a U.S.-source payment because it

[933] 26 U.S.C. §1441(a); 26 U.S.C. §1442(a).
[934] 26 C.F.R. §1.1461-1.
[935] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 39 (Palgrave MacMillan 2013).
[936] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 56 (Palgrave MacMillan 2013).

receives the payment as a gross payment from the USWA.[937] The degree of responsibility that the FFI is held to will vary depending on whether it chooses to assume primary liability for Chapters 3 and 4 withholding and backup withholding responsibility or whether it chooses to delegate certain tasks to a third party.[938] If an FFI chooses to assume primary withholding, the FFI is then in complete control over the process and can assess the documentation and tax consequences directly instead of relying on another intermediary up the chain to do it.[939]

There are two questions a withholding agent should ask regarding income payments.[940] The first is whether the income payment is U.S.-sourced. Is the income payment of a category that is subject to withholding is the second question.[941] There are multiple, applicable tax rates[942] so it is important for the FFI to know which one is applicable to the income payment they have in front of them.[943]

When an FFI gets an income payment, the FFI itself has either elected to be the primary withholder or not. If it has not elected to primarily withhold, then the FFI still needs to be aware that it is still under an obligation to withhold directly when there is an incorrect withholding – the difference between what an upstream withholding agent withheld and what was actually supposed to be withheld.[944] Basically, the non-

[937] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 56 (Palgrave MacMillan 2013).
[938] Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[3] (Thomson Reuters/WG&L).
[939] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 58 (Palgrave MacMillan 2013).
[940] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 58 (Palgrave MacMillan 2013).
[941] 26 C.F.R. §1.1441-1; *See also*, 26 C.F.R. §1.1441-2(a); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 56 (Palgrave MacMillan 2013).
[942] 26 C.F.R. §1.1441-1(b)(4); For example, according to Ross K. McGill, 0% for portfolio interest payments, 10% for non-portfolio, 15% for treaty benefits, 24% for backup withholding on possible U.S. persons, 30% for default statutory rate and 35% and 39.6% for distribution payments from some types of U.S. issuers.
[943] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 57 (Palgrave MacMillan 2013).
[944] IRS Rev. Proc. 2017-15, Section 6, Subsection 3.02(A) and (B); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 57 (Palgrave MacMillan 2013).

withholding QI (NWQI) can outsource withholding but it still retains the liability to make sure the correct amount is withheld and paid.[945] The W-8IMY Form is the document in which the FFI establishes its intention to be a withholding or non-withholding QI.[946] This form is provided to the withholding agent along with the withholding certificate and documentary evidence for the accounts that it is choosing not to withhold on.[947] If the amount withheld by the withholding agent is incorrect, the NWQI is required under the regulations – if the amount has been under-withheld on- to withhold the difference and then remit the payment to the IRS.[948] However, in reality, the NWQI usually works with the United States Withholding Agent to correct the error.[949] According to Ross K. McGill, this exact scenario is why all intermediaries that are in the chain, QI or NQI, are classified as withholding agents.[950]

7.3.1.3.1 Non-Withholding QI – Withholding Procedures

There are two ways for a QI who has not elected to withhold to provide withholding information to the withholding agent and this can be done in one of two ways.[951] The first avenue is for the NWQI to set up several custody accounts[952] at its USWA and each account is identified by the tax rate that should be applied to those assets within

[945] 26 C.F.R. §1.1441-1(e)(3)(iv)(D)(7); *See also*, IRS Rev. Proc. 2017-15
[946] Form W-8IMY, https://www.irs.gov/pub/irs-pdf/fw8imy.pdf ; *See also*, Instructions for Form W-8IMY, https://www.irs.gov/pub/irs-pdf/iw8imy.pdf; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 66 (Palgrave MacMillan 2019).
[947] Form W-8IMY, https://www.irs.gov/pub/irs-pdf/fw8imy.pdf ; *See also*, Instructions for Form W-8IMY, https://www.irs.gov/pub/irs-pdf/iw8imy.pdf; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 66 (Palgrave MacMillan 2019).
[948] Form W-8IMY, https://www.irs.gov/pub/irs-pdf/fw8imy.pdf ; *See also*, Instructions for Form W-8IMY, https://www.irs.gov/pub/irs-pdf/iw8imy.pdf; Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 66 (Palgrave MacMillan 2019).
[949] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[950] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[951] 26 C.F.R. § 1.1441-1(b)(2)(vii)(B); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[952] A custody account, according to Investopedia.com is an account that is maintained by a fiduciarily responsible party on behalf of a beneficiary. Also known as a custodial account https://www.investopedia.com/terms/c/custodialaccount.asp

the specific account.[953] This type of account is called a segregated rate pool account.[954] The NWQI will know as a result of its documentation and due diligence obligations which type of income the clients receive and which segregated rate pool account those income assets should go into.[955] That way the withholding agent will know, based on the type of account, how to tax the payment.[956] However, this type of rate pool can be problematic based on the information the NWQI gets or does not get from its account holders.[957] If documentation is incorrect, then the NWQI does not know that the income payment needs to be moved to a different account.[958] All of these moving parts need to be kept track of in order for the NWQI to stay in compliance.

The second way a NWQI can provide withholding information to the withholding agent is the withholding rate pool statement.[959] Here the NWQI only maintains an omnibus account[960] but since all of the income payments go into the one account, the NWQI now has to instruct the withholding agent on how much to withhold from any payment received.[961] In order to withhold correctly, the NWQI has to instruct the withholding agent on how much to withhold on any payment received.[962] First, the

[953] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[954] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[955] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[956] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[957] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[958] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[959] 26 C.F.R. §1.1441-1(e)(5)(v)(C)(1); *See* also, IRS Rev. Proc. 2017-15, Section 6, 6.03(C); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 59 (Palgrave MacMillan 2013).
[960] An omnibus account is an account that holds the assets of more than one person and allows for anonymity of the persons included in the account. Any transactions that happened are done in the name of the broker. (Investopedia https://www.investopedia.com/terms/o/omnibusaccount.asp)
[961] 26 C.F.R. § 1.1441-1(e)(5)(v)(C)(1); *See also*¸IRS Rev. Proc. 2017-15, Section 6, 6.03(C); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 58 (Palgrave MacMillan 2013).
[962] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 59 (Palgrave MacMillan 2013).

withholding agent tells the NWQI that a payment is pending. Then the NWQI completes its due diligence and based on the information from the due diligence process the NWQI can tell the withholding agent what tax should be withheld in each of the tax categories.[963]

If the FFI has not assumed Chapter 3 withholding responsibility, then it is not required to withhold on a U.S.-source FDAP income payment if it:

1) Does not assume primary withholding responsibility;
2) Provides the withholding agent that the QI receives the payment with a valid withholding certificate that states that the QI does not assume primary withholding responsibility under Chapters 3 and 4; and
3) Provides correct withholding statements as described in subsection 6.02 of the QI Agreement.[964]

7.3.1.3.2 Withholding QI – Procedures

If the FFI has elected to primarily withhold, then the general rule is that they must withhold 30% of any payment of an amount that is subject to withholding made to a foreign payee unless it can reliably associate documentation with a payment to a U.S. person.[965] This rate can be reduced based upon the documentation provided - for example, a non-U.S. person provides a treaty statement to their FFI that they should receive a reduced tax rate under a certain treaty.[966]

[963] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 59 (Palgrave MacMillan 2013).
[964] 26 U.S.C. § 1441(a); *See also*, 26 C.F.R. §1.1441-1(b)(1).
[965] 26 C.F.R. §1.1441-1(b)(1); *See also*, 26 C.F.R. § 1.1441-1(b)(2)(vii)(D)(1); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 181 (Palgrave MacMillian, 2016); Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[3][a] (Thomson Reuters/WG&L).
[966] 26 C.F.R. §1.1441-1(b)(1);

It is not required to assume primary withholding responsibility for all the accounts it holds with a withholding agent but if it does, it is required to assume Chapters 3 and 4 withholding responsibility for all withholdable payments and amounts made by the withholding agent to the account for which the responsibility is assumed.[967]

When a FFI makes the choice to not assume primary withholding responsibility then it has to furnish both a withholding certificate and withholding statement to the withholding agent that it receives a reportable amount from.[968] The withholding statement has to contain enough information so that the withholding agent may apply the correct rate of withholding on payments made to the identified accounts and to report correctly on those payments on Forms 1042-S and 1099 (discussed further down in the chapter).[969] The withholding statement should also include withholding rate pool information sufficient enough so that the withholding agent can meet the Chapters 3 reporting, backup withholding and Forms 1099 and 1042-S obligations.[970]

7.3.1.3.3 Backup Withholding

Somewhere in the chain, an intermediary needs to make the election to backup withhold on U.S. accounts (it only applies to U.S. accounts). It can either be the FFI that holds the account or another intermediary up the chain. If backup withholding occurs upstream, then the FFI who holds the account is responsible for disclosure of the appropriate information so that the upstream intermediary can meet its withholding obligation.[971]

[967] IRS Rev. Proc. 2017-15, Section 6, Subsection 3.03(A).
[968] 26 C.F.R. §1.1441-1(b)(2)(vii)(C).
[969] 26 C.F.R. §1.1441-1(b)(2)(vii)(C).
[970] 26 C.F.R. §1.1441-1(b)(2)(vii)(C).
[971] 26 C.F.R. §1.1441-1(b)(vi)(C)(i).

Backup withholding occurs when a reportable payment is made to an account, but the FFI is unable to ascertain the status of the account because:

1) The payee fails to furnish his tax identification number to the payor in the manner required;
2) The Secretary notifies the payor that the tax identification number furnished by the payee is incorrect;
3) There has been a notified payee underreporting; or
4) There has been a payee certification failure.[972]

Under these situations, the FFI is required to withhold 24% from the reportable payment.[973]

A FFI is required to backup withhold and disclose a reportable amount if the FFI has actual knowledge that a reportable amount is subject to backup withholding and that another payor failed to apply the backup withholding or backup withholding has not been applied by another payor because of a mistake made by the FFI.[974]

The FFI is not required to backup withhold on:

1) A reportable amount it makes to another QI that has assumed primary Form 1099 reporting and backup withholding responsibility with respect to that amount; or
2) A reportable amount that the QI makes to an intermediary or flow-through entity that is a participating FFI registered deemed-compliant FFI or another QI that does not assume primary Form 1099 reporting and backup withholding responsibility with respect to the payment

[972] 26 U.S.C. §3406(a)(1); *See also*, 26 C.F.R. §31.3406(d)-5.
[973] 26 U.S.C. §3406(a)(1); *See also*, IRS Rev. Proc. 2017-15, Section 6, 2.07 and 3.04. The QI Agreement quotes 28% as the backup withholding rate but Public Law 115-97 changed the backup withholding rate from 28% to 24%.
[974] IRS Rev. Proc. 2017-15, Section 6, Subsection 3.06 (A) and (B).

> provided that such intermediary or flow-through entity allocated the payment on its withholding statement to a Chapter 4 withholding rate pool of U.S: payees and the withholding statement is associated with a valid Form W-8IMY that provides the applicable certification(s) for allocating the payment to this pool or allocates the payment on its withholding statement to a Chapter 4 withholding rate pool of recalcitrant owners.[975]

If a withholdable payment is also a reportable payment and is subject to backup withholding (discussed further in a later section below) under §3406, the FFI is not required to withhold under this section if it withheld under Chapter 4 (FACTA Withholding discussed in Chapter 9).[976]

7.3.1.3.4 Depositing Tax Withheld[977]

Only FFIs that withhold are responsible for depositing tax.[978] Non-withholding QIs (NWQI) have their tax withheld by another upstream intermediary. According to Ross K. McGill, this section has three questions to answer[979]: Who does the QI/withholding agent send the tax to? How does the withholding agent deposit the tax withheld? When does the withholding agent have to deposit?

The answer to the first question is simple. The U.S. Department of Treasury is who the deposit is sent to. The IRS only receives the documentation and reports from the FFIs, never the money.[980]

[975] IRS Rev. Proc. 2017-15, Section 6, Subsection 3.07.
[976] IRS Rev. Proc. 2017-15, Section 6, Subsection 3.04(B).
[977] 26 C.F.R. §1.1461-1.
[978] 26 C.F.R. §1.1461-1(a)(1).
[979] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 60 (Palgrave MacMillan 2013).
[980] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* (Palgrave MacMillan 2013).

When the FFI has withheld tax, how do they deposit it with the Treasury Department? When the FFI assumes primary withholding responsibility under Chapters 3 and 4 or primary Form 1099 reporting and backup withholding responsibility, it is required to deposit the amounts withheld by electronic funds transfer.[981]

Finally, there is a schedule of sorts that the FFI must follow to deposit the money with the Treasury. If the aggregate amount of the undeposited taxes is $200 or more, then the withholding agent is required to deposit the amount by the 15th day of the following month.[982] However, if the amount is $2,000 or more, then the withholding agent is required to deposit the amount within 3 business days after the close of the quarterly month period.[983] If by the end of the year, the aggregate amount is less than $200, then the withholding agent has until the 15th of March of the following calendar year to deposit the taxes.[984] If the FFI is a non-U.S. payor that does not assume chapters 3 and 4 primary withholding responsibility, primary form 1099 reporting or backup withholding responsibility, the FFI is required to deposit the amounts withheld by the 15th day following the month in which the withholding took place.[985]

If the withholding agent fails to withhold, the withholding agent is then liable under 26 U.S.C. §1463 for the tax due.[986] But the payee also remains liable for the tax and is required to file a U.S. tax return.[987]

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981 26 U.S.C. §6302; *See also*, 26 C.F.R. §1.6302-2; 26 U.S.C. 6302; 31 C.F.R. §31.6302-1(h); IRS Rev. Proc. 2017-15, Section 6, Subsection 3.08.
982 26 U.S.C. §6302; *See also*¸ 26 C.F.R. §1.6302-2(a)(1)(i).
983 26 U.S.C. §6302; *See also*¸ 26 C.F.R. §1.6302-2(a)(1)(ii).
984 26 U.S.C. §6302; *See also*¸ 26 C.F.R. §1.6302-2(a)(1)(iv).
985 IRS Rev. Proc. 2017-15, Section 6, Subsection 3.08.
986 26 U.S.C. §1463; *See also*, David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016).
987 David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016).

7.3.1.3.5 Over- and Under-withholding

There are procedures in both the regulations and the QI agreement for when over-and under-withholding occurs.[988] When a withholding agent has over-withheld, a FFI may request that the withholding agent make an adjustment by repaying the FFI for the amount over-withheld by either reimbursing or through a set-off procedure.[989] This situation applies when the FFI does not assume the primary withholding responsibility.[990] However, when the FFI has the primary withholding responsibility, the FFI may make adjustments for amounts paid to its account holders when the FFI has over-withheld.[991] This can also be accomplished through the reimbursement or set-off procedures.[992]

There is also a provision in this section for when a FFI discovers or knows that an amount should have been withheld from a previous payment to an account holder or payee but was not withheld.[993] The FFI may withhold from future payments to the account holder or payee in order to *"satisfy the tax from property that it holds in custody for such person or property over which it has control."*[994] If the FFI (or the reviewer or IRS) determines - after a Form 1042 has been filed - that the FFI under-withheld, the FFI shall file an amended Form 1042 to report and pay the under-withheld tax.[995]

[988] 26 C.F.R. 1.1441-3 (b)(8); *See also*, IRS Rev. Proc. 2017-15 Section 6, 9.01-9.06.
[989] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.01s and 9.01(A).
[990] IRS Rev. Proc. 2017-15, Section 6, Subsections 9.01 and 9.01(A).
[991] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.02(A).
[992] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.02(A) and (B).
[993] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.05.
[994] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.05.
[995] IRS Rev. Proc. 2017-15, Section 6, Subsection 9.05.

7.3.1.4 Information Reporting and Tax Returns[996]

Reporting is one of the most important aspects of the QI program's control and oversight of QIs and NQIs.[997] As this chapter has shown, all U.S.-sourced income paid to all recipients outside the U.S has to be reported – both Americans and foreigners. FFIs must file both information reports and tax returns – for example, Forms 1042 and 1042-S - which are used for decidedly different purposes.[998] Each legal entity acting as a QI under the QI Agreement has to file separate information forms.[999] A statement explaining any over- or under-withholding and the amounts must be attached to the form.[1000] Tax returns must also be filed detailing the tax withheld on certain types of income on non-U.S. persons and which was also reported on the information report.[1001] The forms in this section are IRS Form 1042 which is the tax return and Form 1042-S which is the information report.

7.3.1.4.1 Information Reporting

If the U.S.-source income payment is to a U.S. person then that payment must be reported to the IRS via Form 1099.[1002] The financial institution is required to file a Form 1099 for both a reportable amount and a reportable payment. There are multiple versions of the 1099 which are grouped based on the type of income that the account holder receives.[1003] For example, the Form 1099-INT is filed when the

[996] 26 C.F.R. §1.1461-1(b) & (c)(1).
[997] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[998] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[999] IRS Rev. Proc. 2017-15, Section 6, Subsection 7.01(A).
[1000] IRS Rev. Proc. 2017-15, Section 6, Subsection 7.01(A).
[1001] IRS, *Form 1042*, https://www.irs.gov/forms-pubs/about-form-1042
[1002] IRS Rev. Proc. 2017-15, Section 6, Subsection 8.06; *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[8][a][ii] (Thomson Reuters/WG&L).
[1003] IRS Rev. Proc. 2017-15, Section 6, Subsection 8.06; *See also*, IRS, Form 1099-DIV,https://www.irs.gov/forms-pubs/about-form-1099-div and IRS, Form 1099-INT, https://www.irs.gov/forms-pubs/about-form-1099-int

income paid is from interest and the Form 1099-Div is filed when the income comes from dividends or a distribution.[1004] The financial institution must file the correct version of the 1099 depending on the type of income paid.[1005]

When the U.S.-sourced income payment is made to a non-U.S. person then the QI/NQI files a different information report.[1006] If the financial institution has a QI agreement with the IRS, under the Agreement, the financial institution (QI) can protect the identity of its non-U.S. direct customers by using pooled reporting.[1007] The use of the term "direct customers" is a crucial distinction because even a QI cannot pool the reporting of their indirect customers.[1008] Pooled reporting is where the QI classifies all its direct non-U.S. customers' U.S.-sourced income by tax rate and income type.[1009] This sorted information is put onto a separate Form 1042-S for each type of tax rate and income type.[1010] This ability to pool the reporting of direct

[1004] IRS Rev. Proc. 2017-15, Section 6, Subsection 8.06; *See also*, IRS, Form 1099-DIV,https://www.irs.gov/forms-pubs/about-form-1099-div and IRS, Form 1099-INT, https://www.irs.gov/forms-pubs/about-form-1099-int
[1005] IRS Rev. Proc. 2017-15, Section 6, Subsection 8.06.
[1006] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1007] IRS Rev. Proc. 2017-15, Section 6,8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1008] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1009] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1010] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).

customers is one of the benefits of being under the QI Agreement.[1011] If there is no QI Agreement between the financial institution and the IRS, then the financial institutions (NQIs) are expected to report all the beneficial owners to the IRS directly.[1012]

The form used to report U.S.-source FDAP income paid to non-U.S. recipients – either individually or through pooling – is Form 1042-S and is titled Foreign Person's U.S.-Source Income Subject to Withholding.[1013] A QI, as noted above, can pool direct customers and report them according to tax rate and income type on a single 1042-S. In contrast, with indirect customers a QI has to file a separate 1042-S form for amounts paid to each separate indirect customer.[1014] A NQI has to file a Form 1042-S for each of its customers that receive U.S.-source income.[1015]

The 1042-S is a break-down of all of the details about the foreign person's income including the tax rate the income is subject to, the federal tax withheld, tax paid by withholding agents, etc.[1016] The 1042-S requires the following information from the QI:

1) The name, address, TIN of the withholding agent and the withholding agent's status for chapter 3 purposes;

[1011] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1012] IRS Rev. Proc. 2017-15, Section 6, 8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2013).
[1013] IRS Rev. Proc. 2017-15, Section 6,Subsection8.01; *See also*, IRS, Form 1042-S, https://www.irs.gov/forms-pubs/about-form-1042-s; David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 182 (Palgrave MacMillian, 2016).
[1014] IRS Rev. Proc. 2017-15, Section 6, Subsection 8.02.
[1015] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 60 (Palgrave MacMillan 2019).
[1016] 26 C.F.R. §1.1461-1(c)(3)(i)-(ix); See also, IRS, *Form 1042-S, found at* https://www.irs.gov/pub/irs-pdf/f1042s.pdf

2) A description of each category of income paid based on the income codes provided on the form and the aggregate amount in each category expressed in U.S. dollars;

3) For a payment not subject to withholding under chapter 4, the rate of withholding applied or the basis for exempting the payment from withholding under chapter 3, and the exemption applicable to the payment for chapter 4 purposes

4) The name and address of the recipient;

5) The name and address of any nonqualified intermediary, flow-through entity, or U.S. branch to which the payment was made;

6) The taxpayer identifying number of the recipient if required under § 1.1441-1(e)(4)(vii) or if actually known to the withholding agent making the return;

7) The taxpayer identifying number of a nonqualified intermediary or flow-through entity (to the extent it is not a recipient) or other flow-through entity to the extent it is known to the withholding agent;

8) The country of the recipient and of any nonqualified intermediary or flow-through entity the name of which appears on the form; and

9) Such information as the form or the instructions may require in addition to, or in lieu of, information required under this paragraph (c)(3).[1017]

[1017] 26 C.F.R. §1.1461-1(c)(3)(i)-(ix).

7.3.1.4.2 Tax Returns[1018]

In contrast to the informational reports that the FFIs have to file, they are required to file tax returns at the end of the year – for example, Form 1042 which is the Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.[1019] Whereas the informational report (1042-S) just gives information about the account and the payments the FFI received, this form reports the tax that the QI withheld under Chapter 3 regulations as well as payments that get reported on the informational report.[1020]

Another form that the FFI needs to file is the Form 945 known as the Annual Return of Withholding Federal Income Tax which is used to report non-payroll type payments including backup withholding.[1021]

7.3.1.5 Control and Oversight

From the above sections, it is obvious to see that the QI program regulations and QI agreement are complicated and to ensure that the QIs are complying with the regulations and the agreement, the QI agreement provides for compliance procedures to oversee that the QI system is being administered properly.[1022] The compliance procedure for the reviewer to follow was originally laid out in IRS Revenue Procedure 2002-55 but was updated in Revenue Procedure 2017-15 which contains the most updated QI Agreement.[1023]

This compliance procedure only applies to those QIs that execute a QI agreement. Ross K. McGill suggests that NQIs are not subject to a compliance and oversight

[1018] 26 C.F.R. §1.1461-1(b)(1).
[1019] IRS, *Form 1042, found at* https://www.irs.gov/forms-pubs/about-form-1042
[1020] 26 C.F.R. §1.1461-1(b)(1).
[1021] IRS Rev. Proc. 2017-15, Section 6, Subsection 7.02; *See also*, IRS, Form 945, https://www.irs.gov/forms-pubs/about-form-945; 26 U.S.C. §3406.
[1022] IRS Rev. Proc. 2017-15, Section 6, 10.01-10.08.
[1023] IRS Rev. Proc. 2017-15.

system in his book.[1024] Research has not been able to confirm whether the IRS has addressed this flaw but this a significant flaw that should be addressed since "*the estimated number of NQIs outstrips the number of QIs nearly ten to one"*.[1025] This means that the majority of financial institutions are not subject to the oversight and control that is needed to ensure compliance.[1026] The U.S. government should address this flaw because this is a loophole that could be utilized by U.S. taxpayers to evade their taxes by putting their accounts with NQIs they know do not have the oversight that ensures compliance with the documentation, reporting of and withholding on their accounts. It also means the IRS cannot guarantee the information they are getting on U.S. taxpayers from NQIs is accurate. One way to address this flaw would be to subject the NQIs to the same compliance process that a QI must follow but place the compliance within the regulations. If an NQI receives a U.S.-sourced payment, they are subject to the U.S. tax statute and regulations and are considered a withholding agent and the only way around this is for the NQIs to not manage U.S.-sourced payments. This would be hard to do unless they closed accounts that receive those types of payments. As a result, if the U.S. created a compliance program within the regulations, then the NQI would be held accountable and the IRS would have oversight over them as well. The Foreign Account Tax Compliance Act (FATCA Chapter 9) fills in some of this need. It penalizes a FFI 30% on incoming U.S.-source FDAP income that goes to a recalcitrant[1027] account holder (individual or entity) or a non-participating FFI (more details in chapter 9).

QIs, subject to their QI agreement with the IRS do have a compliance program that they have to adhere to. The compliance program is not an audit because the report that is handed over after the process is simply a factual report of the finding and the

[1024] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 77 (Palgrave MacMillan 2013).
[1025] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,*77 (Palgrave MacMillan 2013).
[1026] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,*77 (Palgrave MacMillan 2013).
[1027] A recalcitrant account holder is an account holder of a passive FFI or registered deemed-compliant FFI that has failed to provide the FFI maintaining U.S. account with information required under regulation 26 C.F.R. §1.1471-5.

reviewer does not give an opinion.[1028] The QI Agreement covers the scope, the sampling methodology and the actual procedure that is required to be performed.

7.3.1.5.1 Scope

The scope of the review includes reviewing the documentation, withholding rate pools, withholding responsibilities, return filing and information reporting.[1029] The reviewer must also verify that no significant change was discovered in the course of the review.[1030]

7.3.1.5.2 Sampling Methodology

The QI procedures provide for the methodology of what accounts will be tested to ensure compliance during the review.[1031] The review must test accounts related to the QI's obligations with regard to documentation, withholding, reporting and other obligations under the QI Agreement and its Chapter 4 FATCA (discussed in Chapter 9) requirements for which it is acting as a QI.[1032] Through this testing of accounts, the reviewer should identify any deficiencies in meeting these obligations.[1033] If a third party is used, the third party must provide the necessary information for the QI to test accounts and transactions.[1034] If there are more than sixty account, then a sample of accounts must be reviewed. However, if there are less than sixty accounts then each

[1028] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,*77 (Palgrave MacMillan 2013).
[1029] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05(A)-(D).
[1030] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05(E).
[1031] IRS Rev. Proc. 2017-15, Section 6, 10.05.
[1032] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05.
[1033] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05.
[1034] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05.

account needs to be reviewed.[1035] This is a new adjustment to the most current QI Agreement. Previous to the 2017 QI Agreement, the QI had to review all accounts.[1036]

7.3.1.5.3 Procedures

Section 6, subsection 10 describes the compliance procedures that a QI has to follow in order to confirm its compliance with the QI Agreement which has two major pieces to it: a periodic certification of internal controls and a periodic review that enables the certification.[1037] The QI is required to adopt a compliance program that includes policies, procedures, and processes that are sufficient for a QI to fulfill the documentation, reporting and withholding requirements of the QI Agreement as well as being sufficient for the Responsible Officer of the QI to certify that the QI is in compliance with the QI Agreement.[1038]

The QI is required to appoint a Responsible Officer (hereinafter "R.O.") to oversee the compliance program and to make periodic certifications that the QI is in compliance.[1039] A Responsible Officer is defined as "an officer of the QI with sufficient authority to fulfill the duties of a responsible officer as described in Section 10 of this Agreement, including the requirements to periodically certify and to respond to requests by the IRS for additional information to review the QI's compliance."[1040] The R.O. is responsible for establishing a compliance program that assists the QI in

[1035] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.05.
[1036] Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[10] (Thomson Reuters/WG&L).
[1037] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.01; *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[10] (Thomson Reuters/WG&L).
[1038] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.01(A); *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[10] (Thomson Reuters/WG&L).
[1039] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.02 and Subsection 10.06; *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[19[a] (Thomson Reuters/WG&L).
[1040] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.02; *See also*, IRS Rev. Proc. 2017-15, Section 6, Subsection 2.72; Marnin J. Michaels, I*nternational Taxation: Withholding*, ¶4.03[10][a] (Thomson Reuters/WG&L).

complying with the requirements of the Agreement as well as making certifications and providing the IRS certain information regarding the QI every three years.[1041]

The R.O. has to make those certifications every three years to the IRS which includes certain information regarding the QI through either an independent internal or external reviewer.[1042] In order to make those certifications, the R.O. has to ensure that the QI is compliant in multiple areas which include (but are not limited to):

1) written policies and procedures for both Chapter 3 (QI) withholding and Chapter 4 (FATCA – Chapter 9) withholding;
2) training for relevant staff who are affected by the QI program and FATCA;
3) any systems that are required to be in place to ensure compliance in the fundamental areas – documentation, reporting and withholding - of the QI Agreement; and
4) compliance with periodic review requirements (this part replaced the old external audit from the Agreed Upon Procedure).[1043]

After ensuring these areas are in compliance, then the R.O. can certify to the IRS regarding compliance and disclose to the IRS any material failures that occurred.[1044]

The conclusions from the periodic review must be provided in a written report that is addressed to the R.O. of the QI and must be available, upon request, to the IRS.[1045] If the report is in another language other than English, a certified translation must be provided.[1046] The report must:

1) Describe the scope of the report;

[1041] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.01-10.08
[1042] IRS Rev. Proc. 2017-15, Section 6, 10.04(A)(1)-(2).
[1043] IRS Rev. Proc. 2017-15, Section 6, 10.02(A)(1), 10.02(A)(2), 10.02(A)(3), 10.02(A)(6).
[1044] IRS Rev. Proc. 2017-15, Section 6, 10.03; *See also,* Marnin J. Michaels, *International Taxation: Withholding*, ¶4.03[10][b] (Thomson Reuters/WG&L).
[1045] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.06(A).
[1046] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.06(A).

2) Outline the actions taken to satisfy each of the requirements of subsection 10.05(A)-(E) (this includes a methodology for the sampling of accounts) of the QI Agreement; and
3) Include details about the documentation and tax deposit and payment failures identified and cured before the review was finalized.[1047]

The reports must be retained by the QI for as long as the QI Agreement is in effect.[1048]

Part of the oversight is the ability of the IRS to request a copy of the results of the periodic review and the QI has 30 days to respond to the request.[1049] The IRS can also conduct additional fact finding through a correspondence review if they find it to be necessary.[1050]

7.3.1.6 Penalties

Penalties apply to both QIs and NQIs and are a result of multiple reasons such as late filing of forms, inaccurate information, under-withholding on payments and perjury.[1051]

There is a detailed penalty structure to the QI program.[1052] For example, the penalty for filing late forms – such as a 1042-S – is dependent upon the total gross receipts of the U.S.-source FDAP income.[1053] If gross receipts are more than $5 million then the

[1047] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.06(A).
[1048] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.06(D).
[1049] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.08(B).
[1050] IRS Rev. Proc. 2017-15, Section 6, Subsection 10.08(C).
[1051] See 26 U.S.C. §1461, 26 U.S.C. §1462, 26 U.S.C. §6656, 26 U.S.C. §6721 and §6722; *See also*¸ Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,84 (Palgrave MacMillan 2013).
[1052] The penalties can be found in Chapters 3, 4, 6, and 26 U.S.C. §3406, 26 U.S.C. §6721 and 26 U.S.C. §6722.
[1053] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).

penalty is $270 per form.[1054] This penalty is capped at $3,282,500.[1055] If the late filing is corrected within 30 days the penalty drops to $50 per form and capped at $547,000.[1056] If corrected after 30 days, then the penalty is $100 per form and capped at $1,641,000.[1057]

If the IRS believes that the QI/NQI has intentionally disregarded its obligations, they are then subject to a penalty of $540 per form and it is uncapped.[1058]

The intentional disregard for the QI Program obligations either under the QI Agreement or the regulations should incur a steep penalty. Tax evasion is a serious and ongoing issue and if the IRS wants to receive the information on U.S. taxpayers' foreign accounts, then a high penalty to enforce the compliance of the QIs and NQIs that choose to deliberately mislead is highly appropriate.

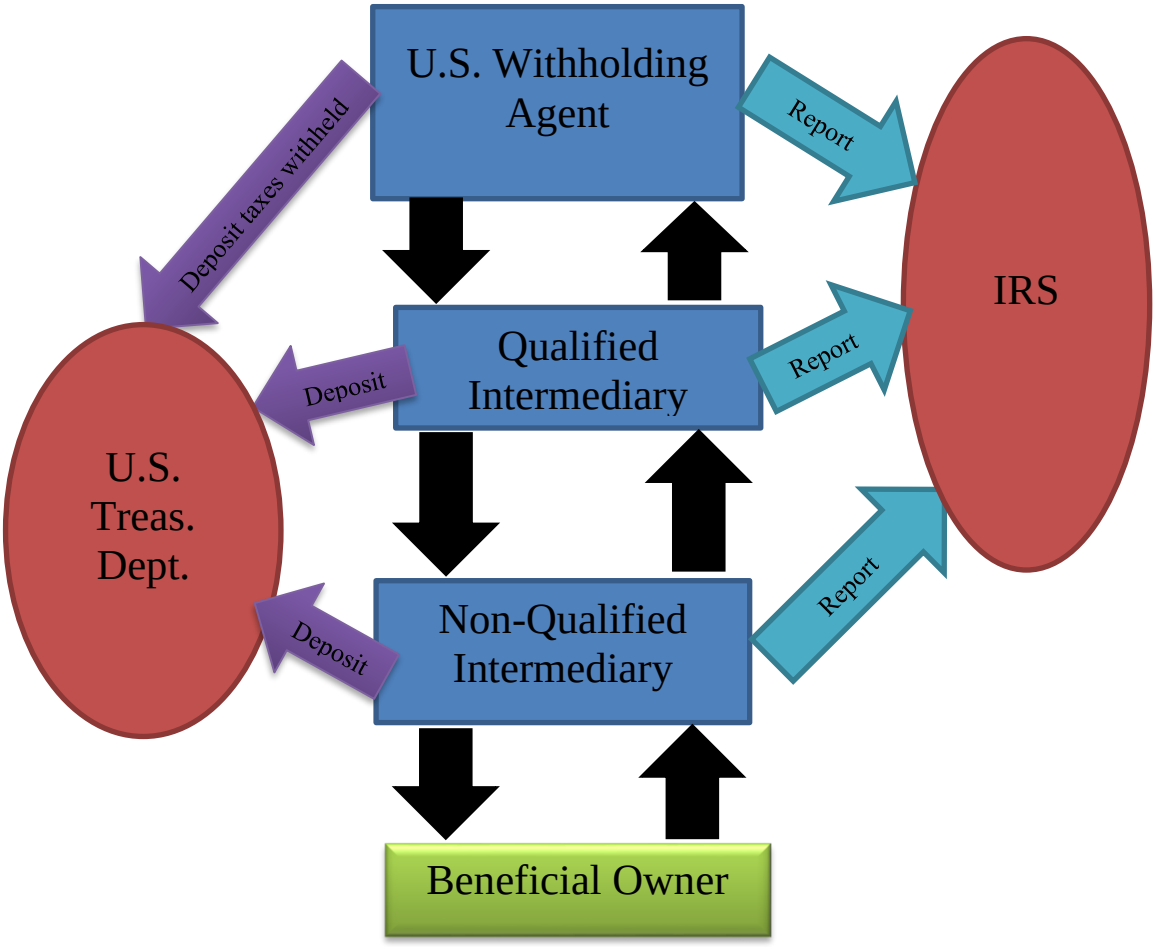
While the intentional disregard of the QI program and regulations should be penalized steeply, the problem for many NQIs (and even QIs) is that the QI program is complicated law and not all NQIs understand the obligations that they are under or even that they are under obligations when they receive U.S.-source FDAP income payments. The answer to this problem is to have a reasonable cause exception similar to the one found in the FBAR penalty structure (Chapter 4). Situations such as limited English language skills or not being aware of the obligations could fall under this exception. This is in line with Ross McGill suggestion outlined in the following paragraph.

[1054] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[1055] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[1056] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[1057] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[1058] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).

If a penalty is assessed the QI or NQI has two options: Pay the penalty or request mitigation.[1059] Ross K. McGill suggests drafting (by a lawyer) a Reasonable Cause Defense letter where the QI or NQI gives a reasonable explanation for what occurred.[1060] He also suggests that the QI/NQI should outline what steps they will take to ensure the failure never happens again.[1061] Ignorance is not bliss where the IRS is concerned – in fact, it is risky and potentially very expensive.

[1059] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,86 (Palgrave MacMillan 2013).
[1060] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,86 (Palgrave MacMillan 2013).
[1061] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,86 (Palgrave MacMillan 2013).

7.4. DIAGRAM OF CHAPTER 3 RELATIONSHIPS[1062]



[1062] This diagram is presented to try to show the relationships and in which direction the various pieces of the QI program flows. The down arrows demonstrate that the FDAP Income payments flow downward and the up arrows represent the information that flows upward to the USWA which tells the other QIs in the chain what has to be withheld and how much. The purple arrows represent the money that is deposited with the U.S. Treasury and the aquamarine arrows represent the information reporting that is given to the IRS. The U.S. Treasury only gets the payments of taxes withheld while the IRS only receives the reports containing the information on the various parties in the chain. It is a overly simplistic diagram. For more detailed diagrams, see Ross K. McGill's book: Withholding Tax: Practical Implications of QI and FATCA.

7.5. PROBLEMS WITH THE QI

Before the 2017 QI Agreement, significant flaws were found in the information that was furnished to the IRS by the FFIs that identified the beneficial owners of the foreign accounts.[1063] Congress held hearings to address these flaws and found multiple issues.[1064] These flaws were manipulated by U.S. taxpayers and their financial advisors to evade U.S. tax and avoid reporting U.S.-source income.[1065] A 2007 GAO report found that the FFIs were manipulating their QI reporting duties in order to avoid reporting client accounts.[1066] One flaw that presented itself was that the QI program did not require a "*look-through*" of foreign shell companies to determine if the beneficial owner was a U.S. taxpayer.[1067] Another fault was that in the original draft of the QI there was not a provision that covered whether an external auditor was required to follow up on indications of fraud or illegal activity by the qualified intermediary.[1068] The Qualified Intermediaries were required to verify the account

[1063] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS,* GAO-09-478T, 10 (March 2009; Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015).

[1064] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of The U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts,* 35 N.W. J. Int'l L. & Bus. 687 (Fall 2015); *See also,* Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage,* 36 Fordham Int'l L. J. 1767, 1788 (2013).

[1065] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-10 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[1066] GAO, *Tax Compliance: Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Witheld and Reported, But Can Be Improved,* GAO-08-99 (December 2007); *See also*, David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 187 (Palgrave MacMillian, 2016).

[1067] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of The U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts,* 35 N.W. J. Int'l L. & Bus. 687 (Fall 2015); *See also,* Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage,* 36 Fordham Int'l L. J. 1767, 1788 (2013); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 187 (Palgrave MacMillian, 2016).

[1068] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of The U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts,* 35 N.W. J. Int'l L. & Bus. 687 (Fall 2015); *See also,* Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage,* 36 Fordham Int'l L. J. 1767, 1788 (2013).

holder's identity – in other words, complete due diligence to make sure the account owner is who they say they are and whether that person is a U.S. citizen – but the QI program also allowed for the withholding agent to accept self-certification.[1069] Self-certification seems to have presented the same problems that voluntary compliance has with individual taxpayers in not complying.

The hope was that the program would improve compliance regarding tax withholding and reporting on U.S. source income that gets funneled to offshore accounts[1070], however, in light of the complications and the flaws and examples like UBS as discussed below, this purpose was not fully realized. Between the abuse of provisions and the fact that not all FFIs are participants in the QI program, the ability of U.S. citizens to hide assets from the U.S. government continued.[1071] This also reflects, partially, the problem of NQIs not having oversight as discussed in subsection 7.3.1.5.[1072] In fact, a GAO report noted that the QI program was "*insufficient to address all offshore tax evasion."*[1073] This is not surprising considering it mostly addresses non-resident aliens' U.S.-source income payments and not the foreign accounts or U.S.-source payments to Americans which is covered in Chapter 4 withholding (FATCA, Chapter 9).

Another notable issue that Congress found was that the QI program only applied to banks and not to other types of financial institutions.[1074] Based on the obvious gaps in

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[1069] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS,* GAO-09-478T, 10 (March 2009.

[1070] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* (2009), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context

[1071] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* (2009), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context

[1072] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* (2009), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context

[1073] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS,* GAO-09-478T (March 2009).

[1074] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-10 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

the law at the time, legislators needed to fill in those holes and they saw FATCA as the golden opportunity to fulfill this need.[1075] They also addressed some of the flaws by updating the QI Agreement.

The UBS case was an excellent illustration that demonstrated the vulnerabilities of the QI program that the FFIs took advantage of aby not disclosing U.S. accounts with billions in assets.[1076] UBS, taking advantage of the flaws of the QI program, helped their U.S. clients by setting up foreign entities in tax haven jurisdictions and then identified the accounts as being owned by foreign corporations or other types of foreign entities which allowed the QI to claim those accounts were not subject to the QI Agreement's reporting requirements.[1077] UBS, who was a QI, did not file Form 1099 form to report U.S. owned accounts to the IRS like they were required to do under the QI Agreement.[1078] The estimation is that UBS held 20,000 accounts and 19,000 of those account were undisclosed.[1079] The total assets of the undisclosed accounts equaled roughly $20 billion.[1080] The old version of the QI program allowed both banks and U.S. taxpayers to evade the rules through various schemes but it also

[1075] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* at 10 (2009), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context
[1076] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS,* GAO-09-478T, 11 (March 2009; *See also*, Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015); Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case*, 43 Cornell Int'l L.J. 409, 422-423 (2010); David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age,* 153 (Palgrave MacMillian, 2016).
[1077] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism*, 21 ILSA J. Int'l & Comp. Law 333, 357-358 (Spring 2015); *See also*, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case*, 43 Cornell Int'l L.J. 409, 422-423 (2010); Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013).
[1078] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age,* 188 (Palgrave MacMillian, 2016); See also, Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1789 (2013).
[1079] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age,* 187-188 (Palgrave MacMillian, 2016).
[1080] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age,* 187-188 (Palgrave MacMillian, 2016).

allowed financial institutions to block information reporting on income earned by foreign taxpayers whose identities were not revealed to the U.S. government or to the foreign taxpayer's government.[1081] The combination of both bank secrecy and the nominee foreign corporations that the U.S. owners hid behind played an important role in the abuse of the QI program by foreign financial institutions like UBS.[1082]

A 2008 report on tax havens presented suggestions for strengthening the QI program and analyzing the present QI agreement.[1083] Those suggestions have been implemented in the 2017 QI Agreement.[1084] One suggestion that was implemented was to require the FFIs that participate in the QI program to utilize KYC rules and identify the beneficial owners of the accounts.[1085] This is reinforced by the list of approved KYC jurisdictions that the IRS maintains. Another implementation was requiring domestic FIs and FFIs to file Form 1099 for all U.S. taxpayer clients and accounts that are beneficially owned by U.S. persons even if the account is titled in the name of a foreign corporation, trust or other foreign entity and regardless of whether the account holds U.S. securities.[1086] The presumption rules, if no documentation is found or if the documentation is not reliable, presumes the status of an account holder to be that of a U.S. person until reliable documentation is provided. This has allowed that the U.S.-source payment be taxed at 30% until its proven that, through solid evidence, the recipient of the payment is entitled to a lower rate.[1087]

[1081] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 180 (Palgrave MacMillian, 2016).
[1082] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 179, (Palgrave MacMillian, 2016).
[1083] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 179, (Palgrave MacMillian, 2016).
[1084] U.S. Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance* (2008); *See also*, David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 189 (Palgrave MacMillian, 2016).
[1085] IRS Rev. Proc. 2017-15, Section 6, Subsections 5.01, 5.08 and 5.09; *See also*, U.S. Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance* (2008).
[1086] IRS Rev. Proc. 2017-15, Section 6, Subsections 5.08, 5.09, and 8.06; *See also*, U.S. Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance* (2008).
[1087] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,3 (Palgrave MacMillan 2019).

Another implementation was to revoke the status of a QI for FFIs that fail to disclose accounts or impede U.S. investigations.[1088]

The QI Agreement detailed in the previous pages is not the same QI Agreement that UBS and other FFIs were able to abuse. The QI agreement above was redrafted in 2017 with the focus on looking beyond the shell corporations (or "look through") to the beneficial owners to see if they are U.S. owners who should have tax withheld in order to be in compliance with the law or if they are non-U.S. persons that should be taxed at different amounts depending on various circumstances (i.e., treaty benefits). That has been the main purpose behind the QI program. The QI was implemented so that the Department of the Treasury had reliable information to correctly apply the proper withholding of income while also allowing acceptable reductions to qualifying taxpayers under a treaty or a domestic legal regime.[1089] This most recent QI Agreement still allows the acceptable reductions but at the same time requires the QI to make sure that the beneficial owner, whether a foreign person or a U.S. person is identified, reported, and taxed accordingly. This fits squarely within the QI program being a measure which allows the U.S. government to access information on a U.S. taxpayer's foreign accounts.

Another critical flaw with the QI program is the issue brought up briefly subsection 7.3.1.2.2 that pertains to cultural and linguistic differences. According to Ross K. McGill *"if you draw a line from Washington D.C. eastwards, the level of knowledge, understanding and compliance to Chapter 3 falls rapidly with distance.*"[1090] There are multiple reasons for this: culture, language, English is not the corporate language of choice like it is in some countries, English is not a second or even a third language

[1088] IRS Rev. Proc. 2017-15, Section 6, Subsection 11.06(A)-(S); *See also*, U.S. Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance* (2008).
[1089] David Kerzner and David W. Chodikoff, *International Tax Evasion in the Global Information Age*, 179-180 (Palgrave MacMillian, 2016).
[1090] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,3 (Palgrave MacMillan 2013).

etc.[1091] In McGill's 2019 update to his book, [1092]he notes that the failure rate for the validation of W-8BEN forms has not improved since the first edition published in 2013. Legal language (in any language) is complex and perplexing unless one has been trained as a lawyer – and even then, it can still be difficult. Asking a second-language English learner who may not be a lawyer to fully understand and comply with a law in American Legal English is a flaw that should be addressed.

7.6. QUALIFIED INTERMEDIARY PROGRAM: CONCLUSION

The Qualified Intermediary program is an anti-tax evasion measure that uses third-party foreign financial institutions (FFIs) to document, withholding, deposit tax and report on U.S.-sourced FDAP income payments made to non-U.S. persons.

The QI Program is a complicated set of laws and regulations that require the FFIs in the chain to document their customers and themselves when a U.S.-source payment is received through Know Your Customer or self-certification procedures. Based on the information received, through the documentation process, the information flows upward and the withholding on the payment occurs either at the FFI's level or with another withholding agent up the chain. The FFIs are required to file both informational reports and tax returns with the IRS and Treasury, respectively. A penalty structure exists to punish any violations of the program such as late filing or under-withholding on payments.

Similar to the other anti-tax evasion measures utilized by the IRS to try to obtain information on U.S. taxpayers' foreign accounts, the QI program is not a perfect

[1091] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*,3 (Palgrave MacMillan 2013).
[1092] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).

program. The QI program relies on the FFIs to not only accurately and honestly withhold and to report the information on account holders received through the documentation process. While the 2017 update to the QI Agreement as well as the regulations closed the beneficial owner loophole by requiring the use of due diligence in the KYC procedures to ascertain the beneficial owner, there are still problems with the QI program.

As stated earlier in the chapter, the Foreign Account Tax Compliance Act (FATCA Chapter 9) has helped in addressing some of the problems of the QI through the use of 30% penalty on U.S.-source payments to the FFI if the recipient of those payments are made to non-participating FFIs or recalcitrant account holders – either individuals or entities. Also, the due diligence requirement of both the QI program and FATCA to ascertain the beneficial owner and whether they are a U.S. person or not has solved one of the major loopholes. The due diligence requirement allows the IRS, if the QI/NQI is in compliance, to receive information on the U.S. taxpayers' foreign accounts.

Despite FATCA filling in some of the gaps, the QI has a few key issues that should be addressed. For instance, one of the main problems is that it is an extremely complicated and onerous measure that is complicated enough for U.S. legal and financial professionals, but then to expect second language English learners to understand all that they need to understand to comply is alarming considering that they will be subject strict penalties especially if the IRS believes that the FFI has acted intentionally in being non-compliant. This issue leads back to the earlier discussion of cultural and linguistic problems with complying with the QI program. Ross McGill estimates that between 30% and 75% of W-8BEN forms are invalid and that the failure rates become higher the farther east one moves (Europe to Asia).[1093] If the documentation is invalid due to language and the ability to understand the QI program and its obligations, then the IRS is not acquiring the

[1093] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan, 2019).

taxpayer information they are seeking – at least not the correct information – to help them. For both QIs and NQIs, it is crucial for them to understand that if the documentation is not correct then the withholding will not be correct, and both are important to the IRS.

The language problem is not an issue that can be solved overnight, however, the U.S. government (namely the IRS) can and should do a few things to help the FFIs (both QIs and NQIs) be able to understand the program so that they can be in compliance and the IRS can get the information they are seeking along with the correct tax being withheld. It is important to get the idea across to the FFIs – especially those that are NQIs – that the minute they get a U.S.-source FDAP income payment, they fall under U.S. law (Chapter 3 requirements). The IRS should, as much as possible, publish guides that help second-language English learners understand the rules and regulations of the QI program. Using plain language – not technical language or legalese – will help those who are not American lawyers understand what their obligations are under the QI Agreement, United States Code and the regulations. Other ways the IRS government could help to ensure compliance from FFIs is to provide diagrams similar to the examples they give in the regulations. The IRS could also provide online courses via online video conferencing, Youtube.com videos, blogs and podcasts that are specifically targeted towards those that work in FFIs to help them understand and comply. These avenues, though, should always contain plain, concise English so that a non-native speaker can understand it and be able to truly comply. The ability of the IRS to educate and help those FFIs understand and comply with the QI program will only help the IRS to obtain the information on U.S. taxpayers' foreign accounts. These types of solutions can help to solve many of the non-compliance issues. However, these suggestions also raise a concern that should be considered. For example, if the advice that is found on a YouTube channel or podcast that the IRS chooses to start to help FFIs understand the QI program is wrong and the FFI acts on the incorrect advice, would the IRS hold the FFIs be liable for that mistake. The answer to that dilemma should not be an outright no. The FFI should be

able to prove that the podcast or video was the reason for them acting and not for another reason such as bad judgment.

The issue presented in subsection 7.3.1.2.2 regarding the issue of tax forms that are handwritten presents another cultural and linguistic dilemma. The identification and documentation of U.S. taxpayers is one of the most important purposes of the QI program. When identification and documentation are done correctly, then the U.S. receives the information that it is looking for and can administer the tax laws correctly and fairly. Allowing substitute forms and electronic systems – which the regulations allow – solves some of the issues that are cultural and linguistic in nature. For example, substitute forms that are in the native language of the client and that comply with the regulations enable the client to provide more accurate information to the FFI. This in turn provides the IRS with more accurate information to administer the tax laws correctly. Electronic systems are an alternative to handwritten forms that is allowed in the regulations and allow either a scanned image or a pdf. of the W-8 or substitute form. Electronic systems where the client can fill out a W-8 form (or substitute form) online without having to handwrite the information is the better route because it solves the issue of the FFI being able to comprehend a person's handwriting. Of course, as McGill notes, the effort must outweigh the risks including the cost to create the electronic system and it is usually only the larger institutions like J.P. Chase Morgan that would be able to have such a system. However, the online form should allow for room to completely answer the question as the paper form does not always have that room which presents the problem of shortened answers and abbreviations the FFI might not understand. Both the substitute forms and electronic systems provide the client the opportunity to provide the FFI with more accurate information so that on the back end the IRS is provided with the most up-to-date, accurate information. No system is perfect. There are a couple of issues that present themselves with the electronic systems. For instance, ensuring that the person who enters the information and executes (signs) the electronic form and submits it is the same person named in the form. If the FFI has the capability of giving their clients code cards similar to the NemID cards that Denmark has for its citizens, then the client

could be required to input their username and password to get a code that allows them to both verify that it is the client themselves and to execute the document. This could be a requirement that the IRS has of the FFI. Another issue to consider is that the regulations say that the form(s) should include a penalty of perjury statement where the person executes the form under penalty of perjury, however this legal concept of "perjury" probably does not translate to all other cultures. Many U.S. legal concepts do not translate into a legal concept for other cultures – for example, trusts are not a legal concept that has a substantially similar concept in other countries. The U.S. would be hard pressed to enforce a penalty of perjury charge in another jurisdiction of a non-U.S. citizen. Despite the issues, the substitute forms and electronic systems allowed in the regulations are good alternatives that help to solve some of the cultural and linguistic issues.

Another major issue that is not as easy to solve is the oversight and control – or lack thereof – of the NQIs. The IRS believes NQIs are instigators of tax evasion because they are believed to be assisting in tax evasion when they refuse to share their customers' information with the IRS. Much of that, the author believes, results from the lack of understanding of their obligations and the simple fact that they are subject to the U.S. Chapter 3 when they receive the U.S.-source income payment. It is doubtful that thousands of NQIs would deliberately not comply with U.S. law if they knew of the obligations of Chapter 3. However, it is naïve to think that there are not some NQIs out there that are deliberately refusing to comply and participate in assisting U.S. taxpayers evade U.S. law. This is a loophole that can be easily manipulated by those U.S. taxpayers wanting to evade taxes by simply choosing an NQI that refuses to disclose. The QIs agree to the control and oversight in the QI Agreement, but the NQI does not subject itself to the same since it is not under a QI Agreement. The IRS could attempt to encourage those NQIs that are in jurisdictions that have approved KYC rules to become Qualified Intermediaries. That would bring some of the NQIs under the control and oversight portion of the QI Agreement. The U.S. could attempt to create a more rigid compliance program within the regulations specifically directed at the NQIs that would also be connected

to the penalty structure. Harsher penalties could be instituted for those that are NQIS if they are not in compliance. However, a bit of caution here since some NQIs do not understand what their obligations are under Chapter 3. Earlier it was noted that intentional disregard of the obligations should be harshly penalized, however, a reasonable cause exception should be instituted. If a compliance program is drafted in the regulations aimed at the NQIs, then a reasonable cause exception should be included. This should be considered for the NQIs even more so than the QIs, because the QIs executed an agreement and that signals they are well aware of their obligations (or should be).

Chapter 3 discussed blacklists and tax haven definitions and how they are not an effective approach to secrecy. One place, however, the U.S. might consider using a well-reasoned tax haven definition or blacklist would be within the Qualified Intermediary program (See Chapter 7). The IRS – in creating the QI program – noted that the jurisdictions that refused to cooperate with the program and were considered tax haven jurisdictions (or bank secrecy jurisdictions) needed more stringent oversight over the FFIs or their branches located in those jurisdictions.[1094] For this scenario, a tax haven definition or a blacklist could help in identifying those jurisdictions where the FFIs need more oversight and also provide some incentive for the FFIs to fully cooperate with the program if they know they will be under more scrutiny because of the secrecy their jurisdiction provides to those looking for it.

The next chapter, Chapter 8, discusses the utilization of article 26 in U.S. tax treaties along with Tax Information Exchange Agreements as an anti-tax evasion measure as another way, through governmental means, to access information on U.S. taxpayers' foreign accounts.

[1094] IRS Rev. Proc. 2017-15; *See also,* IRS Announcement 2000-48, 2000-1 C.B. 1243; Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens*, 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

CHAPTER 8. ART. 26 OF THE U.S. MODEL INCOME TAX TREATY & TAX INFORMATION EXCHANGE AGREEMENTS

8.1. INTRODUCTION

The previous chapters analyzed and examined anti-tax evasion measures that the Internal Revenue Service (hereinafter IRS) uses to obtain information on U.S. taxpayers' foreign accounts. These anti-tax evasion measures use the taxpayers themselves (chapters 4 and 5), third parties (chapter 6) and foreign financial institutions (chapter 7) to procure the information they are seeking. These measures alone are not successful for several reasons least of which are non-compliance by the taxpayers and foreign financial institutions. Another avenue to obtaining the information needed to administer U.S. tax law correctly is via U.S. tax treaties with foreign governments. A tax treaty covers multiple issues, but this chapter is focused on article 26 of U.S. tax treaties as anti-tax evasion.

The chapter begins with a discussion of general information of U.S. tax treaties before focusing on article 26 of the U.S. Model Income Tax Convention (hereinafter U.S. Tax Convention) which is the relevant article for this thesis. Article 26 is the section of the U.S. Tax Convention that addresses the exchange of information between the U.S. government and a foreign government. Next, the chapter presents a case study on the U.S. – Switzerland treaty which examines the treaty to determine whether treaties can allow the U.S. government to get the information on U.S. taxpayers' foreign accounts or whether there are issues that exist to impede this exchange of information. The chapter then moves into a quick examination of Tax Information Exchange Agreements (hereinafter TIEAs) that the U.S. utilizes when it does not have a tax treaty with a foreign government. This section also questions whether these

TIEAs allow the IRS to procure the information they seek on U.S. taxpayers' foreign accounts. Finally, the chapter looks at two questions. First, when a request for information is made under art. 26, does the U.S. receive the information needed so that all the facts are known so that the U.S. tax authorities can apply the law correctly and fairly? Second, if art. 26 in the tax treaties cannot provide the U.S. government the information the IRS seeks, what can be done to ensure that requesting information under art. 26 is effective in getting the information needed?

This chapter will not discuss the Treaty on Mutual Assistance in Criminal Matters (MACM) because although this treaty was an attempt at sharing information this treaty does not allow disclosure of tax information in relation to tax evasion unless there is an unrelated offense such as drug trafficking that accompanies it.

8.2. BILATERAL TAX TREATIES

One anti-tax evasion measure that the U.S. in its arsenal to obtain information on U.S. taxpayers' foreign accounts are tax treaties, the cornerstone of international tax information exchange[1095], and Tax Information Exchange Agreements (TIEAs) that the US is a party to.[1096] Generally, as described in the literature, income tax treaties have four purposes: 1) avoiding double taxation, 2) avoiding discriminatory tax treatment of residents of the contracting states, 3) establishing taxing rights (or limiting them) among the contracting states, and 4) reducing tax evasion through

[1095] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, (2013).
[1096] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).

allowing the contracting states to enforce their domestic tax laws more effectively.[1097] Both tax treaties and TIEAs are used to further tax enforcement via official agreements with foreign governments.[1098] Considering, this thesis is concerned with using anti-tax evasion measures to obtain information on U.S. foreign accounts of U.S. taxpayers in order to enforce the U.S. domestic tax law, the fourth purpose noted above is relevant. Based on this, the chapter will focus on the information exchange provision found in art. 26 of the U. S. Tax Convention and the TIEAs

The United States needed (and still needs) a way to obtain information from other countries regarding U.S. taxpayers' financial activities to prevent abuse of the taxpayer system which relies heavily on voluntary compliance. When other avenues have failed, the U.S. government can utilize the tax treaties via art. 26 to request information from foreign governments on U.S. taxpayers' foreign accounts abroad. Art. 26, the exchange provision, in the income tax treaty is considered the quickest and most effective way to access that information but it is also not without limitations.[1099]

The U.S. Tax Convention[1100] presents the official stance of U.S. treaty policy and introduces the U.S.' standard position given when it negotiates income tax treaties with foreign jurisdictions.[1101] The purpose of the U.S. Tax Convention is to avoid

[1097] Richard E. Andersen, *Analysis of United States Income Tax Treaties*, ¶1.01 (September 2010, Thomson Reuters Tax and Accounting); See also, Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1768 (2013); Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 44 (Palgrave MacMillian 2016); U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, Tax Haven Banks and U.S. Tax Compliance, 17 (July 2008).

[1098] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).

[1099] Richard E. Andersen, *Analysis of United States Income Tax Treaties*, ¶1.01[2] (September 2010, Thomson Reuters Tax and Accounting).

[1100] The latest Model Income Tax Convention was updated in 2016 but article 26 was not updated from the 2006 Model Income Tax Convention.

[1101] Joseph Isenbergh, *International Taxation*, 224-225 (Foundation Press 3rd ed., 2010); *See also*, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).

double taxation for the citizens of the Contracting States while reducing tax evasion.[1102] The U.S. Tax Convention is also the starting point when the U.S. negotiates treaties with foreign jurisdictions.[1103] It has been developed based on previous U.S. models, the Organization for Economic Cooperation and Development (hereinafter OECD) Model Double Taxation Convention on Income and Capital as well as other various sources.[1104] The technical explanation that accompanies the U.S. Tax Convention is "*an official guide to the convention….reflects policies behind particular Convention provisions as well as understandings reached with respect to the application and interpretation of the Convention"*.[1105] Other interpretative devices used to construe U.S. tax treaties include examining the plain language of the treaties, the intention of the parties and using the OECD Model Draft Conventions and Commentaries.[1106]

While the U.S. has the Model Tax Convention as the standard, its necessary to remember no one treaty is exactly like the Model treaty – each treaty is unique.[1107] Although the U.S. tax treaty goes over multiple topics – such as limitation on benefits – this chapter is only concerned with art. 26 of the U.S. Tax Convention.

[1102] Technical Explanations to the 2006 U.S. Model Income Tax Convention; *See* also, Stephen J. Dunn, *Foreign Accounts Compliance* §6.2 (August 2018).
[1103] Stephen J. Dunn, Foreign Accounts Compliance §6.2 (August 2018); See also, Laura Szarmach, Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case, 43 Cornell Int'l L. J. 409, 420 (2010).
[1104] Technical Explanations to the 1996 U.S. Model Tax Income Tax Convention; *See also* Technical Explanations to the 2006 U.S. Model Income Tax Convention; International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 781 (2013).
[1105] Technical Explanations to the 2006 U.S. Model Income Tax Convention.
[1106] *U.S. v. A.L. Burbank and Co., Ltd*., 525 F.2d 9 (2nd Cir. 1975); See also, *Nat'l Westminster Bank, PLC v. U.S.*, 44 Fed. Cl. 120 (1999), aff'd in *Nat'l Westminster Bank, PLC v. U.S*., 512 F.3d 1347 (Fed. Cir. 2008); *McManus v. U.S.*, 130 Fed. Cl. 613, 620 (2017) (quoting *Nat'l Westminster Bank, PLC v. U.S.,* 512 F.3d 1347 (Fed. Cir. 2008); Joel D. Kuntz, Robert J. Peroni and John A. Bogdanski, *U.S. International Taxation*, ¶C4.01 (March 2019 Thomsen Reuters Tax and Accounting); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 46 (Palgrave MacMillian 2016).
[1107] Joseph Isenbergh, *International Taxation*, 225 (Foundation Press 3rd ed., 2010); *See also*, Internal Revenue Manual, 35.4.5.2.3 (Dec. 21, 2010); *See also*, International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779 (2013).

8.2.1. IMPLEMENTATION OF ARTICLE 26

The purpose of art. 26 is to allow the authorization of the exchange of information between the U.S. and a foreign government and to "*prevent or curb tax evasion*".[1108] This provision outlines the process of the exchange of information between the United States government and its treaty partner. It is reflective of the OECD's Model and it also relies on the statutory language found in U.S. domestic tax law. This section will describe and analyze the article. It is important to reiterate here that each treaty is unique and will specify procedures that are necessary to obtain information documents which reflects the unique relationship the U.S. has with each country that it has a treaty with.[1109] This section addresses only the U.S. Tax Convention's Article 26. Individual treaties between the U.S. and foreign countries should be examined on their own.

Paragraph 1 of the provision is the authorization paragraph that obligates the U.S. and its treaty partner to obtain and provide information relevant to the Convention or domestic laws of the Contracting States concerning taxes of every kind unless they contravene the Convention.[1110] The U.S. Tax Convention's art. 26 contains much broader language than some specific treaty language — such as in the U.S.-Swiss treaty — which will be discussed in the next section. The language used says *"….the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of the present Convention or the domestic laws of the Contracting States concerning taxes of every kind…."*[1111] This language incorporates

[1108] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010); See also, Ernest R. Larkins, *U.S. Income Tax Tax Treaties In Research and Planning: A Primer*, 18 Va. Tax Rev. 133, 204 (Summer 1998).
[1109] Internal Revenue Manual, 4.60.1.2 (Jan. 1, 2002).
[1110] U.S. Model Income Tax Convention, art. 26, para. 1 (2016); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][a] (2019).
[1111] U.S. Model Income Tax Convention, art. 26, para. 1 (2016); *See also*, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).

the language of 26 U.S.C. §7602 which gives the authorities the legal basis to examine documents, persons or to take testimony in the course of an investigation.[1112] The "*relevant for carrying out…" language has been interpreted to include even "items of potential relevance*."[1113] However, the Treasury clarified that the request must be relatively definitive because a request where information regarding all bank accounts maintained by residents (American) in the requesting Contracting State that are held in the non-requesting Contracting State would not be allowed for being too broad.[1114] This broad type of request is analogous to the fishing expeditions discussed in the John Doe summons (chapter 6) and procedural discovery in civil litigation where discovery has to be relevant to the claim and proportional to the needs of the case.[1115]

The obligation to keep the information that is exchanged confidential is found in paragraph 2.[1116] This obligation requires that the information be kept confidential in keeping with the treaty partner's domestic laws and that the information can only be disclosed to relevant persons and authorities involved in the "*assessment, collection, or administration of, enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to in paragraph 1 of the Article*."[1117] This confidentiality also reflects U.S. domestic policy on confidentiality of tax returns and is found in 26 U.S.C.§6103 and §6105. 26 U.S.C. §6103 addresses the U.S.' domestic policy of keeping both the disclosure of and the information contained in U.S. tax

[1112] 26 U.S.C. §7602; See also, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).
[1113] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010) (quoting United States v. Arthur Young & Co., 465 U.S. 805 (1984).
[1114] Technical Explanations to the 2006 U.S. Model Income Tax Convention, Art. 26, para.1; *See also*, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010).
[1115] Fed. Rules. Civ. Pro. Rule 26 (b)(1)
[1116] U.S. Model Income Tax Convention, art. 26, para. 2 (2016); *See also*, Internal Revenue Manual, 35.4.5.2.3 (Dec. 21, 2010); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][a] (2019); Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010); International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 799 (2013).
[1117] U.S. Model Income Tax Convention, art. 26, para. 2 (2016).

returns confidential.[1118] 26 U.S.C. §6105 reflects the U.S.' policy on the confidentiality under treaties and that policy is pretty definitive: tax convention information shall not be disclosed.[1119] §6105, does however, contain exceptions similar to those found in paragraph 2 of art. 26[1120]. For example, tax convention information can be disclosed to persons or authorities that are entitled to disclosure under the applicable tax convention.[1121]

Paragraph 3 states that the two previous paragraphs of the article are not to be understood to impose an obligation on a Contracting State that contravenes or is not obtainable under the laws of the Contracting State.[1122] It is also not required to exchange information that would disclose "*any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy*."[1123] The policy of the U.S reflects this. *"….the USA has a policy of not carrying out administrative measures at variance with the laws and administrative practice of either contracting state, not supplying information that contracting states would not be able to obtain under their own laws, and not providing information that would disclose trade, business, industrial, commercial, or professional secret or trade process, or information that would be contrary to public policy of either contracting state*."[1124] Paragraph 3 places limitations on art. 26 and is where the biggest weakness lies. This weakness is found in the potential for a Contracting State (like Switzerland) to assert that they cannot provide the information due to the bank secrecy laws in the Contracting State.[1125] This

[1118] 26 U.S.C. §6103
[1119] 26 U.S.C. §6105 (a).
[1120] 26 U.S.C. §6103 (b).
[1121] 26 U.S.C. §6103 (b).
[1122] U.S. Model Income Tax Convention, art. 26, para. 3 (2016); *See also,* Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).
[1123] U.S. Model Income Tax Convention, art. 26, para. 3 (2016).
[1124] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 800 (2013).
[1125] U.S. Model Income Tax Convention, art. 26, para. 3 (2016); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][a] (2019); Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 420 (2010).

would then prohibit the U.S. government from obtaining the information on U.S. taxpayers' foreign accounts.

The non-requesting Contracting State cannot refuse to supply information to a requesting Contracting State simply because the non-requesting Contracting State has no domestic interest in the information being requested.[1126] The Contracting State has an obligation under paragraph 4 to gather information to obtain the requested information despite not needing the information for itself.[1127] The obligation to gather information is subject to the paragraph 3 limitations.

Paragraph 5 states that a Contracting State cannot refuse to deny exchanging information requested based on the fact that the information is held by *"a bank, other financial institution, nominee or person acting in agency or a fiduciary capacity or because it related to ownership interests in a person"*.[1128] The last part of paragraph 5 addresses the beneficial ownership of the information. This paragraph's purpose is to prevent a Contracting State from relying on paragraph 3 by invoking bank secrecy laws that would cancel out the paragraph 1 obligation to provide information.[1129]

Art. 26 also addresses in what form the information should be provided.[1130] The information requested should be given to the requesting Contracting State in the form of depositions of witnesses and authenticated copies of unedited, original documents which includes books, papers, statements, records, accounts, and writings.[1131] This aligns with 26 U.S.C. §7602 which allows the IRS to review books, papers, etc., in order to assess the correctness of a return or to make a return.[1132]

[1126] U.S. Model Income Tax Convention, art. 26, para. 4 (2016).
[1127] U.S. Model Income Tax Convention, art. 26, para. 4 (2016).
[1128] U.S. Model Income Tax Convention, art. 26, para. 5 (2016).
[1129] U.S. Model Income Tax Convention, art. 26, para. 5 (2016); *See also*, Technical Explanations to the 2006 U.S. Model Income Tax Convention, Art. 26, para 5.
[1130] U.S. Model Income Tax Convention, art. 26, para. 6 (2016); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][a] (2019).
[1131] U.S. Model Income Tax Convention, art. 26, para. 6 (2016).
[1132] 26 U.S.C. §7602(A)(1).

Paragraph 7 obligates the Contracting State to "*endeavor to collect on behalf of the other Contracting State such amounts as been necessary to ensure that relief granted by the Convention from taxation imposed by that other Contracting State does not inure to the benefit of persons not entitled thereto*."[1133] The technical comments explain that the non-requesting Contracting State is obligated to tax collection assistance in the case of third parties that are not obligated to receive benefits under the treaty.[1134] This is to ensure that only persons entitled to treaty benefits receive them under the Tax Convention terms.[1135]

Paragraph 8 is the provision that obligates the non-requesting Contracting State to allow representatives of the Contracting State to enter the requested State and interview persons and examine books and records in the jurisdiction of the non-requesting Contracting State.[1136] The persons involved must consent to the interviews and examinations.[1137]

The final paragraph under art. 26, paragraph 9, addresses how the competent authorities of each Contracting State may draft an agreement on the mode of application of art. 26 which includes an agreement that would ensure that both Contracting States provide comparable levels of assistance to each other.[1138] If the parties do not have such an agreement, that does not relieve a Contracting State from their obligations under art. 26.[1139]

[1133] U.S. Model Income Tax Convention, art. 26, para. 7 (2016); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][a] (2019).
[1134] U.S. Model Income Tax Convention, art. 26, para. 7 (2016); *See also*, Technical Explanations to the 2006 U.S. Model Income Tax Convention; Reuven S. Avi-Yonah and Martin B. Tittle, *The New United States Model Income Tax Convention*, 61 Bulletin Int'l Tax'n 224, 232 (2007)
[1135] U.S. Model Income Tax Convention, art. 26, para. 7 (2016).
[1136] U.S. Model Income Tax Convention, art. 26, para. 8 (2016).
[1137] U.S. Model Income Tax Convention, art. 26, para. 8 (2016).
[1138] U.S. Model Income Tax Convention, art. 26, para. 9 (2016); *See also*, International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 797 (2013).
[1139] U.S. Model Income Tax Convention, art. 26, para. 9 (2016).

The U.S. Tax Convention states throughout the treaty that the Contracting States' Competent Authorities oversee the exchange of information and following procedures put in place by the treaty.[1140] Art. 3 of the U.S. Tax Convention contains the definitions for the treaty and the Competent Authority definition defines the Competent Authority for the U.S. as the Secretary of the Treasury or his delegate (usually the IRS) and the Competent Authority for the foreign jurisdiction is left blank to be filled in with the corresponding foreign authority.[1141]

8.3. U.S. – SWISS TAX TREATY: CASE STUDY

This next section examines the treaty relationship between the U.S. and Switzerland and analyzes how this treaty example demonstrates that treaties have shortcomings that prevent the U.S. government from procuring information on U.S. taxpayers' foreign accounts.

8.3.1. BACKGROUND ON SWISS SECRECY

The starting point is the very differing views of bank secrecy by the United States and Switzerland. The Swiss view secrecy as a vital protection of the individual and the individual's privacy and this privacy encompasses financial affairs.[1142] This view on privacy (or confidentiality) saved thousands from the threat of execution by the Nazis prior to and during WWII which is discussed in more detail below.[1143] The U.S., on

[1140] Internal Revenue Manual, 35.4.5.2.3 (Dec. 21, 2010).
[1141] U.S. Model Income Tax Convention, art. 3 (g); *See also*, International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 798 (2013).
[1142] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011); See also, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1827 (2010).
[1143] Niels Jensenn, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1827 (2010).

the other hand, views bank secrecy as a threat to the tax revenue and the tax system. "….. *the U.S. legal system generally views foreign bank secrecy laws as promoting and facilitating illegal activity*…."[1144] The main difference lies in who bankers can disclose to without breaking the confidentiality between banker and client. U.S. law agrees that bankers have a duty to not disclose customer information to third parties unless that third party is the government.[1145] The Swiss government, in contrast, does not differentiate unless there is a substantial reason to disclose to a government entity. An example of a substantial reason would be tax fraud which under Swiss law is a criminal offense.[1146] But tax evasion would not qualify as a substantial reason because tax evasion is not considered a crime.[1147] This is discussed further below.

The reputation the Swiss have for bank secrecy has existed since the 16th century but really developed over the last century.[1148] Bank secrecy in Switzerland really took flight in the 1930s when the Nazi government enacted legislation requiring their

[1144] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687 (Fall 2015).
[1145] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687 (Fall 2015).
[1146] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 359 (2010).
[1147] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 359 (2010).
[1148] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 356 (2010).

citizens to disclose all foreign assets.[1149] The penalty of not disclosing those assets was a capital offense and the Germans executed those that did not disclose.[1150]

In reaction to this, the Swiss enacted the Federal Act on Banks and Savings Banks (Swiss Banking Act) which included article 47 which "established a code of secrecy for banking and account information".[1151] Art. 47's duty extends to officers, directors, employees and agents of a bank and requires them to protect the confidentiality or face criminal sanctions.[1152] That statute in combination with penal code art. 273 created the almost impenetrable wall that protects the customer's privacy.[1153] The purpose of this was to prevent the divulging of a private individual's banking information to foreign governments and to create a lawyer-client like privilege which

[1149] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, 91 Cong. Rec. 16952 (May 25th, 1970); Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 736 (2014); Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 357 (2010); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 817 (Summer 2011).

[1150] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 736 (2014); See also, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1827 (2010).

[1151] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 357 (2010); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 817 (Summer 2011); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1827 (2010).

[1152] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 823 (Summer 2011).

[1153] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 823 (Summer 2011).

made the breaking of that privilege a crime.[1154] The most important aspect of this legislation – and the biggest problem from the perspective of the U.S. – is that taxing authorities such as the IRS have not been able to procure information about a customer and his financial affairs from the financial institution for tax purposes.[1155] The legislative history demonstrates that the Swiss government decided that the "*bankers professional duty to secrecy outweighs any financial disadvantage to the exchequer*[1156] *which may arise*" and this includes both intentional and negligent disclosures.[1157]

Swiss law distinguishes between two different types of tax offenses: tax infringement and tax fraud.[1158] In the first type of offense, tax infringement, a person purposefully or negligently files an incomplete tax return.[1159] In the second, tax fraud, a person has fraudulently manipulated documents with the intent to mislead tax authorities which can lead to a fine or imprisonment.[1160] An easier way to state this is that, according to the Swiss, tax evasion is obtaining an unjustified tax advantage via an action or omission and not through the use of false documents and tax fraud is when a taxpayer uses false documents to evade taxes.[1161] Tax evasion, under Swiss law, falls into the

[1154] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 691 (Fall 2015); See also, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351 (2010); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 822 (Summer 2011).
[1155] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 823 (Summer 2011).
[1156] Exchequer is a national (or royal) treasury.
[1157] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 823 (Summer 2011).
[1158] Leopoldo Parada, *Lessons Learned from the Swiss Julius Baer Case*, 74 Tax Notes Int'l. 1217, 1220 (June 30, 2014).
[1159] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 827 (Summer 2011).
[1160] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 827 (Summer 2011).
[1161] Leopoldo Parada, *Lessons Learned from the Swiss Julius Baer Case*, 74 Tax Notes Int'l. 1217, 1220 (June 30, 2014).

first category of tax infringement and, therefore, only involves administrative hearings and not criminal hearings.[1162] Secrecy is not lifted for "*mere*" tax evasion.[1163] In contrast to this is the U.S. who views tax evasion as a crime. The Swiss' differentiation between the two frustrates the IRS' ability to collect taxes or information on U.S. taxpayers' foreign accounts.[1164]

International treaties supersede Swiss domestic law so if the IRS can show that the banks have a duty to testify under the terms of the treaty then the bank may be compelled to disclose the requested information.[1165]

Although highly valued, Swiss bank secrecy is not absolute.[1166] It can be lifted for multiple reasons including dealing with foreign authorities but this is a question of law that only Swiss courts can decide.[1167] Bank secrecy in Switzerland is set aside for criminal matters – not civil matters – and since tax evasion is considered an administrative matter the secrecy remains intact, even today.[1168]

[1162] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 827 (Summer 2011).
[1163] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 827 (Summer 2011).
[1164] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?,* 19 Cardozo J. Int'l & Comp. L. 815, 828 (Summer 2011).
[1165] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?,* 19 Cardozo J. Int'l & Comp. L. 815, 828 (Summer 2011).
[1166] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?,* 19 Cardozo J. Int'l & Comp. L. 815, 828 (Summer 2011).
[1167] Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 361 (2010); See also, Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 826 (Summer 2011); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1827 (2010).
[1168] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?,* 19 Cardozo J. Int'l & Comp. L. 815, 8236(Summer 2011).

8.3.2. U.S. – SWISS TREATY

The first U.S.-Swiss treaty was drafted and ratified in 1951.[1169] The purpose of the treaty was to provide administrative assistance in the task of eliminating double taxation for both American and Swiss citizens.[1170] There was little to no focus on tax evasion because Switzerland only agreed to exchange information in the event of tax fraud.[1171] It was carefully worded so that it would only prevent fraud or for the fulfilling of the treaty provisions.[1172] There was no definition of what fraud was or a detailed explanation of the exchange of information process.[1173] The Swiss also did not have to provide evidence to the U.S. in order to help further the U.S.' investigation and subsequent prosecution.[1174]

It has been amended or updated three times since 1951 and all three amendments were focused on fixing the failure of the Swiss in refusing to disclose American accounts.[1175] Of all the amendments, the 2003 amendment was supposed to be a

[1169] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 737 (2014); See also, Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 693 (Fall 2015).
[1170] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 737 (2014); See also, Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 693 (Fall 2015).
[1171] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 693 (Fall 2015).
[1172] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 737 (2014).
[1173] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 737 (2014).
[1174] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 693 (Fall 2015).
[1175] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 738 (2014).

"*gamechanger*"[1176] regarding the almost 100-year-old Swiss tradition of secrecy.[1177] The 2003 amendment is discussed further below.

8.3.2.1 1996 U.S. – Swiss Treaty

The first major update to the 1951 tax treaty took almost fifty years.[1178] It came in the form of the 1996 Treaty and its accompanying protocol.[1179] Art. 26 in the 1996 tax treaty set out the legal basis for an exchange of information as well as allowing the sharing of tax matters that are not wholly dependent on related crimes which is in contrast to other international agreements (such as the MACM) where an exchange of tax information is connected to another criminal offense such as money laundering. This treaty also strengthened the tax information exchange provision by broadening the definition of tax fraud using the language to prevent "*tax fraud or the*

[1176] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 738 (2014).
[1177] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 693 (Fall 2015).
[1178] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997); *See also*, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1832 (2010).
[1179] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997); *See also*, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1832 (2010).

like".[1180] Initially, the wording "*or the like*" seemed to address tax evasion.[1181] However, a 1970 Swiss court interpreted the "*tax fraud or the like*" phrase did not include a duty for the Swiss government to exchange information regarding tax evasion cases and said that it encompassed deception – such as fraudulent or falsified documents – intended to mislead tax authorities.[1182] The parties under the 1996 U.S. – Swiss treaty are "*required to exchange information only when the facts of the alleged tax fraud or evasion would be sufficient to establish fraud or evasion under the laws of both countries*"[1183] which means it has to be considered a crime (such as tax fraud) as defined by Swiss law.

Contemporaneous to the 1996 treaty, the U.S. and Switzerland executed both an MOU (Memorandum of Understanding) and a Protocol.[1184] The Protocol (and the accompanying technical explanation) tried to clarify that "*tax fraud*" included "*acts*

[1180] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol paragraph 10); *See also*, Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 694 (Fall 2015); *See also*, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 382-383 (2010); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 829 (Summer 2011).

[1181] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol paragraph 10); *See also*, Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 694 (Fall 2015); *See also*, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 382-383 (2010); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 829 (Summer 2011).

[1182] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 831 (Summer 2011).

[1183] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 831 (Summer 2011).

[1184] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997); *See also*, Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 383 (2010).

that…..constitute fraudulent conduct with respect to which the requested Contracting State may obtain information under its laws or practices".[1185] According to the 1996 Protocol, tax fraud is defined as "*situations when a taxpayer uses, or has the intention to use, a forged or falsified document*".[1186] It then lists examples that are considered to fall under that definition such as a false invoice, an incorrect balance sheet or profit and loss statement or in a situation known to the Swiss as "*Lügengebäude"* which is a situation where the taxpayer uses or has the intent to use a scheme of lies to defraud the tax authority.[1187] The 1996 Protocol also has a non-exhaustive list of examples that constitute tax fraud and these were included in order to "*clarify for purposes of the Convention the Swiss concept of tax fraud.*"[1188] However, this explanation does not exactly help because, as Niels Jensen points out, tax fraud is defined very narrowly in Swiss law.[1189] Without evidence of falsified documents (not including tax returns) that demonstrate a willful intent to deceive, the bank secrecy will not be lifted.[1190] Art. 26 of the treaty also requires that any information that is requested should be in the form of "*authenticated copies of*

[1185] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol para. 10); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation For the Avoidance of Double Taxation with respect to Taxes on Income (January 1, 1998); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1832 (2010).
[1186] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol para. 10).
[1187] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol para. 10).
[1188] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol para. 10); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation For the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1832 (2010).
[1189] Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1833 (2010).
[1190] Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1833 (2010).

unedited, original records or documents."[1191] In paragraph 8 of the 1996 MOU, records and documents are defined as all forms of recorded information held by either public or private individuals or entities.[1192] This broad cover of all documents was included because the previous treaty did not include in what form the information could be exchanged.[1193] Based on this, the Swiss Supreme Court limited the form of information the Swiss government could provide to the U.S. to only reports and summaries of information.[1194] This form of information obviously limits the U.S. government's ability to detect or discover tax evasion, including tax fraud, so the information element was broadened to cover all types of information to avoid the result of the Swiss not being able to comply.

Paragraph 3 of Article 26 clarifies that the exchange of information obligations do not require the Contracting States to utilize administrative measures that contravene either the regulations and practice or its sovereignty, security or public policy of the either of the Contracting States. The MOU to the 1996 Treaty clarifies, to secure the

[1191] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (Protocol para. 10); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998).

[1192] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (MOU para. 8); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation For the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1832 (2010).

[1193] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (MOU para. 8); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998).

[1194] 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (MOU para. 8); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998).

forwarding of documentary evidence from Swiss banks, that Swiss bank secrecy laws will not hinder this in cases of tax fraud.[1195]

For the Swiss, the strength of the secrecy is not an issue because they do not regard tax evasion as a crime[1196], simply an administrative matter that receives a fine but, as stated earlier, this is stark contrast to the U.S., who considers tax evasion a crime under 26 U.S.C. §7201. The U. S. would then have to meet the "*double incrimination standard"* in order for the Swiss to share information.[1197] This frustrated the purpose of preventing tax evasion and procuring information on U.S. taxpayers' foreign accounts so that the IRS could apply all the facts to administer the tax law correctly. The limitations of the 1996 Treaty's art. 26 – namely, the narrowly defined tax fraud

8.3.2.2 2003 Mutual Agreement on Exchange of Information

Due to the limitations and inadequacies contained in the 1996 tax treaty to prevent tax evasion – since the focus was only on tax fraud – in 2003 an information exchange agreement was signed to further the understanding between the U.S and the Swiss of the 1996 art. 26 and paragraph 10 of the 1996 Protocol.[1198] The 2003 agreement was signed in order to clarify that art. 26 and paragraph 10 of the Protocol will be interpreted to assist in the tax administration and enforcement efforts of each Contracting State, to expand upon the 1996 version of art. 26 and to "*exchange information necessary to properly implement the provisions of the*

1195 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (May 29, 1997) (MOU para. 8); *See also,* Department of Treasury, Technical Explanation of the Convention Between the United States and the Swiss Confederation For the Avoidance of Double Taxation with Respect to Taxes on Income (January 1, 1998).

1196 Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 383 (2010).

1197 Eric M. Victorson, *United States v. UBS AG: Has the United Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 831 (Summer 2011); See also, 26 U.S.C. §7201.

1198 Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996 (Jan. 23, 2003), *See also*, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1833 (2010).

Convention or to prevent tax fraud."[1199] In paragraph 4 of the 2003 Agreement, it broadened the definition of tax fraud by defining the type of conduct that would qualify. This includes (but does not limit):

1) Conduct that is established to defraud individuals or companies, even though the aim of the behavior may not be to commit tax fraud;
2) Conduct that involves the destruction or non-production of records, or the failure to prepare or maintain correct and complete records, that a person is under a legal duty (tax or otherwise) to prepare and keep as sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any tax return, if the person has not properly reported such amounts in any such tax return; or
3) Conduct by a person subject to tax in the requesting State that involves the failure to file a tax return that such a person is under a legal duty to file and an affirmative act that has an effect of deceiving the tax authorities making it difficult to uncover or pursue the failure to file, including the concealment of assets or covering up of sources of income or the handling of one's affairs to avoid making the records that are usual in transactions of the kind.[1200]

It also expanded the definition of tax fraud to include cases where the individual was suspected of committing tax fraud by evading taxes using offshore accounts. In this situation, the Swiss agreed to turn over account information on the individual in

[1199] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996 (Jan. 23, 2003); *See also,* Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 694 (Fall 2015); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1833 (2010).
[1200] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, para. 4 (Jan. 23, 2003).

question.[1201] However, this was on an individual basis and this assumed that the IRS knew the identity of the individual that was using Swiss accounts to evade tax.

The 2003 Agreement also clarified the understanding that when one of the Contracting States has a reasonable suspicion that the conduct would be considered tax fraud or the like that the other Contracting State shall exchange the information requested.[1202] Reasonable suspicion may be based on the following (but the following examples are also not a limitation):

1) Documents, whether authenticated or not, and including, but not limited to, business records, books of accounts or bank account information;
2) Testimonial information from the taxpayer;
3) Information obtained from an informant or other third person that has been independently corroborated or otherwise is likely to be credible; or
4) Circumstantial evidence.[1203]

[1201] Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 695 (Fall 2015); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1833 (2010).
[1202] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, paragraph 5 (Jan. 23, 2003).
[1203] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, paragraph 5 (Jan. 23, 2003).

Paragraph 6 refers to fourteen hypothetical situations found in the Appendix of the agreement that illustrate what tax fraud looks like.[1204] The agreement made clear that the hypotheticals were not to be interpreted as limitations on tax fraud.[1205]

Unfortunately, the "*gamechanger"* moniker noted above regarding the 2003 Agreement turned out to be wrong when, in 2007, Bradley Birkenfeld, a UBS employee, blew the whistle on UBS and its schemes.[1206] UBS had gotten around former reporting requirements (such as the QI) by opening accounts for Americans under nominees.[1207] This move no longer identified the American as the beneficiary of the account.[1208] The American client would then file false returns with the IRS and intentionally leave out the information regarding the UBS accounts.[1209] In 2008, the DOJ issued a John Doe Summons to UBS and alleged that UBS assisted

[1204] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, paragraph 6 (Jan. 23, 2003)
[1205] Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, Appendix (Jan. 23, 2003)
[1206] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 739 (2014); Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S: Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 696 (Fall 2015); Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1828 (2010).
[1207] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1828 (2010).
[1208] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1828 (2010).
[1209] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland,* 63 Vand. L. Rev. 1823, 1828 (2010).

American clients in evading taxes in order to defraud the U.S.[1210] UBS, citing the Swiss bank secrecy laws, refused to cooperate with the summons and also argued that the IRS was supposed to go through the treaty procedure and not directly address UBS itself.[1211] In February of 2009, DOJ sued UBS which was a move designed to force UBS to disclose the identities of 52,000 American account holders who hid $14.8 billion from the IRS.[1212] The DOJ settled the case in the summer of 2009 and in the agreement UBS agreed to disclose up to 10,000 American account holders who were suspected of evading taxes, pay a $780 million fine and end the offshore banking schemes.[1213] The culmination of this case resulted in two things: information on U.S. account holders and a revised tax treaty (2009) that strengthened tax information sharing.[1214] This case was the turning point in the fight against tax evasion and it helped pierce the veil of the Swiss' long history of bank secrecy.[1215] What allowed UBS to refuse disclosure to the IRS? The answer to this question is that because Switzerland does not consider tax evasion as a crime which was the focus of the UBS case, the secrecy would not be lifted by Switzerland.[1216] However, had tax fraud been at issue then the IRS could have gotten Switzerland to

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1210 U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also*, Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 832 (Summer 2011).

1211 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy*?, 19 Cardozo J. Int'l & Comp. L. 815, 832 (Summer 2011).

1212 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 817 (Summer 2011).

1213 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 817 (Summer 2011); See also, Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 Vand. L. Rev. 1823, 1828 (2010).

1214 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 817 (Summer 2011).

1215 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).

1216 Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 826 (Summer 2011).

lift the secrecy. The UBS case was a perfect illustration of how treaties as well as other anti-tax evasion measures' loopholes can be taken advantage of. The UBS scandal, while setting the stage for FATCA and the strengthening of the QI program, also set the stage for the drafting of the 2009 Protocol that would amend the 1996 Treaty.

In 2010, two Swiss courts ruled that when the Swiss Financial Market Supervisory Authority (FINMA) facilitated the UBS agreement as well as ordering UBS to hand over information on 300 clients to US authorities FINMA broke Swiss law.[1217] One of the two courts considered that tax evasion was the issue before the court, not tax fraud, which meant, according to the court, that bank secrecy could not be lifted.[1218] An Swiss appeals court later overturned this decision and that FINMA had acted within the law and with guidance from the Swiss government.[1219]

8.3.2.3 2009 Protocol

After the 2008 bank fiasco, the U.S. negotiated an amendment in 2009, the Protocol Amending The Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income (also called Double Taxation Amendment or DTA).[1220] This amended the 1996 Treaty that resulted from the UBS settlement with the Swiss in hopes of addressing the obvious inadequacies of the previous amendments to address to tax

[1217] Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 389 (2010).
[1218] Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 389 (2010).
[1219] *Court Rules Transfer of UBS Data Legal*, https://www.swissinfo.ch/eng/court-rules-transfer-of-ubs-bank-data-legal/30695554
[1220] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (September 23, 2009); *See also*, Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 740 (2014); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).

evasion.[1221] The part of the DTA that is relevant to the focus of this thesis is the amendment of art. 26. This amendment changed the language of information exchange from "*tax fraud or the like*" to broader language that called for the information exchange to exchange "*such information as may be relevant*" in order to enforce and administer the domestic laws of the U.S. and Switzerland.[1222] The DTA also calls for the execution of the provisions of the 1996 treaty, however, fishing expeditions are still not permissible under the 2009 Protocol.[1223] This new provision includes tax evasion and since the treaties supersede the domestic laws of Switzerland, this protocol supersedes bank secrecy.[1224] However, in order to assuage the Swiss' concerns and to avoid a fishing expedition, an information request has to fulfill five elements:

1) Information on the person allegedly violating the U.S. tax laws;
2) A time frame for which the information is requested;
3) A statement about what kind of information is sought;

[1221] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (September 23, 2009); *See also*, Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 740 (2014); Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).

[1222] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 3 (September 23, 2009);*See also*, Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 833-834 (Summer 2011); Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 384 (2010).

[1223]Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 3 (September 23, 2009);*See also*, Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 833-834 (Summer 2011); Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 384 (2010).

[1224] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 4 (September 23, 2009); *See also*, Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 833-834 (Summer 2011).

4) The tax reason as to why the information is sought; and
5) The name and address of anyone who the U.S. believes possesses such information.[1225]

Eric Victorson argues that the broader scope of information sharing under the 2009 Protocol "*bodes well for both the United States, which seeks information about Americans with assets in Switzerland, and the Swiss Confederation, which is concerned with preserving the integrity of its law from over intrusive, unilateral practices to discover information without the participation or consent of Swiss officials*."[1226] He is correct that it will not allow fishing expeditions which conforms with U.S. domestic law. It also allows the Swiss to protect the privacy of its clients because the procedural requirements for the request of information exchange are very narrow. The Protocol, itself, notes that the procedural requirements are in place to avoid fishing expeditions by one party.[1227] However, this still limits the U.S.' ability to procure information on U.S. taxpayers because the first procedural requirement obligates the United States to know enough information that the IRS could give to the Swiss Competent Authority the name of the individual, and even possibly address, account number or similar information.[1228] The very problem in the past with treaties and TIEAs has been that the IRS needs to give a foreign government information that would identify an individual which is information the

[1225] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 4 (September 23, 2009); *See also,* Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 833-834 (Summer 2011); *See also,* Jaclyn H. Schottenstein, *Is Bank Secrecy Still Bankable?: A Critical Review of Bank Secrecy, Tax Evasion and UBS*, 5 Entrepreneurial Bus. L. J. 351, 384 (2010).
[1226] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?,* 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).
[1227] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 4 (September 23, 2009).
[1228] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 4 (September 23, 2009).

IRS does not always have. Sometimes all the IRS has is the knowledge through a voluntary disclosure program that a scheme or facilitator in a foreign country potentially has multiple American clients.

8.3.2.4 Current Status

This revised treaty still contains limitations that limit the ability of the U.S. government to procure information regarding U.S. taxpayer information abroad. One limitation, specifically, is that there are no provisions that covers automatic information exchange.[1229] The problem that is present with this version of the treaty is that the U.S. still had to go through the formal channels of requesting tax information from the Swiss government instead of it just being automatic.[1230] Eric M. Victorson has argued that it did not "*enhance tax information sharing as effectively as it could*" but it was step in the right direction.[1231]

The 2009 DTA had not been ratified until 2019[1232] as a result of opposition from Senator Rand Paul of Kentucky. He voiced concerns that the provisions of the revised DTA (2009 Protocol) would possibly violate both the 4th amendment right to privacy and the 5th amendment right to due process.[1233] Senator Paul has a valid concern. Both the right to privacy and the right to due process are fundamental

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[1229] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).
[1230] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).
[1231] Eric M. Victorson, *United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy?*, 19 Cardozo J. Int'l & Comp. L. 815, 818 (Summer 2011).
[1232] Jim Tankersley, *Senate Approves Tax Treaties For First Time in Decade*, New York Times (July 17, 2019); *See also, U.S. Senate Approves the Protocol Amending the DTA, found at* https://www.sif.admin.ch/sif/en/home/dokumentation/fokus/us-senat-gibt-gruenes-licht-zum-aenderungsprotokoll.html; *U.S. Ratifies Double-Taxation Deal with Switzerland, found at* https://www.swissinfo.ch/eng/stalemate-ends_us-ratifies-double-taxation-deal-with-switzerland/45103988
[1233] Diane M. Ring, *When International Tax Agreements Fail at Home: A U.S. Example*, 41 Brooks J. Int'l L. 1185 (Fall 2016); *See also*, Jim Tankersley, *Senate Approves Tax Treaties For First Time in Decade*, New York Times (July 17, 2019).

rights under the U.S. Constitution. However, the 2009 DTA provides the taxpayer with a certain amount of protection. The first way it provides protection, although criticized in the last section, is by ensuring that the requesting Contracting State has sufficient information to protect against a fishing expedition.[1234] Another way is by preserving the right of the taxpayer (to appeal/be notified) to administrative procedural rules in the non-requesting Contracting State. A third way, although it is a negative from the U.S. government's perspective, is the refusal to require a Contracting State to commit to automatic exchange of information. The procedural request for information and the protection of the taxpayer's rights to certain procedural protections (notify/appeal) limits the ability of the Contracting States to automatically exchange the information. The DTA also protects the taxpayer's confidentiality (or privacy) under art. 3 paragraph 2 by requiring the information "*shall be treated as secret"* and by limiting the disclosure to "*persons or authorities involved in the administration, assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of such functions*."[1235]

The U.S., after the 2008 bank scandals, took another look at its exchange of information provisions within their treaties and for the treaties.[1236] The U.S. is looking to strengthen treaties that contain weaker exchange of information provisions through revision of art. 26.[1237] If the U.S. does not have a bilateral income

[1234] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 3 (September 23, 2009).
[1235] Protocol Amending the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, art. 3 (September 23, 2009).
[1236] Paul R. McDaniel, James R. Repetti and Diane M. Ring, *Introduction to United States International Taxation*, 187-206 (6th ed., 2014).
[1237] Paul R. McDaniel, James R. Repetti and Diane M. Ring, *Introduction to United States International Taxation*, 187-206 (6th ed., 2014).

tax treaty with jurisdictions, it has been pursuing tax information exchange agreements (TIEAs).[1238]

Effective treaties are treaties where both partner countries have aligned interests[1239], – for example, defeating tax evasion – which is demonstrated in the relationship between the U.S. and the United Kingdom. The opposite situation is reflected in the treaty between the U.S. and Switzerland.[1240]Although it is a treaty between allies, it has not been effective in the exchange of information regarding U.S. citizens' foreign accounts as demonstrated by the discussion above. Although the recent ratification of the 2009 DTA demonstrates that the U.S. and Switzerland may be moving onto the same page regarding exchange of information and tax evasion.

8.4. TAX INFORMATION EXCHANGE AGREEMENTS (TIEAS)

When the U.S. does not have a bilateral tax treaty with a foreign jurisdiction, it pursues a Tax Information Exchange Agreement (hereinafter referred to as "TIEA") which helps close the information gap that is left open by the U.S.' dependence on tax treaties with jurisdictions that are not considered tax havens.[1241] A TIEA is separate from a tax treaty, but does not supersede it.[1242] That is a result of the TIEAs being an executive agreement pursued through the executive branch as opposed to the tax treaties which

[1238] Paul R. McDaniel, James R. Repetti and Diane M. Ring, *Introduction to United States International Taxation*, 187-206 (6th ed., 2014).
[1239] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 735 (2014).
[1240] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 736 (2014).
[1241] Paul R. McDaniel, James R. Repetti and Diane M. Ring, Introduction to United States International Taxation, 187-206 (6th ed., 2014); See also, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS* Case, 43 Cornell Int'l L. J. 409, 421 (2010).
[1242] Internal Revenue Manual, 35.4.5.2.4 (Dec. 21, 2010); *See also,* Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1781 (2013).

have to be ratified by two-thirds of the U.S. Senate (legislative branch).[1243] The purpose of a TIEA is to "*assist each country to assure the accurate assessment and collection of taxes, to prevent fiscal fraud and evasion, and to develop improved information sources for tax matters*."[1244] A TIEA is specific agreement only for the exchanging of tax information and is found between the U.S. and countries who typically are considered "tax havens" because they have no or low taxes.[1245] There are multiple differences between tax treaties and TIEAs. For example, a tax treaty has legal status on par with a statute and which has to be ratified by the Senate whereas a TIEA is an executive agreement authorized by the Secretary of the Treasury.[1246] Another difference is that tax treaties cover various articles designed to reduce double taxation whereas a TIEA is a very specific agreement designed specifically for the exchange of information between the U.S. and foreign jurisdictions.[1247]

The Competent Authority for the United States regarding TIEAs is the Deputy Commissioner of the Large Business and International Division (LB&I).[1248]

Despite the differences, the TIEA also has many characteristics in common with tax treaties. For example, there is a confidentiality duty as well as a duty not to disclose information obtained under a TIEA except to those that are involved with the

[1243] Internal Revenue Manual, 35.4.5.2.4 (Dec. 21, 2010); *See also,* Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1781 (2013).
[1244] Internal Revenue Manual, 35.4.5.2.4 (Dec. 21, 2010).
[1245] U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010).
[1246] Internal Revenue Manual, 35.4.5.2.4 (Dec. 21, 2010).
[1247]U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); *See also,* Internal Revenue Manual, 35.4.5.2.4 (Dec. 21, 2010).
[1248] International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779 (2013); *See also,* Internal Revenue Manual, 35.4.5.2.4 (2) (Dec. 21, 2010).

country's tax administration.[1249] The tax treaty's art. 26 Exchange of Information and the TIEA are reflective of each other. The TIEA is a more detailed[1250], longer version of art. 26 and it also includes more topics than art. 26, for instance, spontaneous exchanges of information.

The TIEA provides for several types of requests for information exchanges: specific, routine (also known as automatic) and spontaneous.[1251] A specific exchange of information is an exchange that is a systematic and recurring conveyance of taxpayer information by the source country to the residence country.[1252] A specific request of information is a request that one treaty partner makes requesting information such as ownership of property, financial information or control of corporations (etc.).[1253] These types of requests are handled on a case-by-case basis.[1254] A simultaneous exchange of information occurs when the treaty countries coordinate a separate yet simultaneous examination of information relating to specific taxpayers.[1255] The spontaneous exchange happens when information is willingly given concerning a specific taxpayer or transaction and when there is no specific request of information that has been undertaken.[1256]

[1249] Internal Revenue Manual, 35.4.5.2.4 (2) (Dec. 21, 2010); *See also*, International Fiscal Association (IFA), *Exchange of Information and Cross-Border Cooperation Between Tax Authorities*, 98 Studies on Int'l Fiscal L. 779, 799 (2013).
[1250] Internal Revenue Manual, 35.4.5.2.4 (3) (Dec. 21, 2010).
[1251] Internal Revenue Manual, 35.4.5.2.4 (3) (Dec. 21, 2010); *See also*, Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][c] (2019).
[1252] Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][c] (2019); See also, OECD, Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Committee on Fiscal Affairs (January 23, 2006).
[1253] Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][d] (2019); See also, OECD, Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Committee on Fiscal Affairs (January 23, 2006).
[1254] Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][d] (2019); See also, OECD, Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Committee on Fiscal Affairs (January 23, 2006).
[1255] Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][e] (2019); See also, OECD, Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Committee on Fiscal Affairs (January 23, 2006).
[1256] Cym H. Lowell and Jack P. Governale, *US International Taxation: Practice and Procedure*, ¶ 9.03[1][g] (2019); See also, OECD, Manual on the Implementation of Exchange of Information Provisions for Tax Purposes, Committee on Fiscal Affairs (January 23, 2006).

The information included is necessary to carry out and enforce the tax laws of the U.S. and the partner country.[1257] Much of the reason the TIEA is more detailed than the tax treaties with regard to information exchanges is due to the TIEA partner not having *"comprehensive procedures in their local law for obtaining information in tax matters."*[1258]

In the course of gathering information under the TIEA, the requested party may:

1) Examine any books, papers, records or other tangible property which may be relevant or material to such inquiry;
2) Question any person having knowledge or in possession, custody or control of information which may be relevant or material to such inquiry;
3) Compel any person having knowledge or in possession, custody or control of information which may be relevant or material to such inquiry to appear at a stated time and place and testify under oath and produce books, papers, records, or other tangible property; or
4) Take such testimony of any individual under oath[1259]

The information gathering process in the TIEA is reflective of art. 26 under the U.S. Model Income Tax Convention.

While the TIEA is an alternative to a tax treaty, this type of agreement has several limitations where enforcement of U.S. tax law is concerned.[1260] For instance, many of the agreements only apply to criminal matters, and even more limiting, is that an added requirement that sometimes shows up in the TIEA is that the violation has to be a

[1257] Internal Revenue Manual, 35.4.5.2.4 (3) (Dec. 21, 2010).
[1258] Internal Revenue Manual, 35.4.5.2.4 (3) (Dec. 21, 2010).
[1259] Internal Revenue Manual, 35.4.5.2.4 (4) (Dec. 21, 2010).
[1260] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010).

crime in both countries, not just one. This is similar to the issue found with the U.S.-Swiss treaty and the different views on tax evasion being a crime. Another limitation to the TIEAs is that these agreements do not override bank secrecy laws.[1261] A significant limitation and the source of some frustration for the IRS is that the TIEAs usually require an information exchange upon request only which means the IRS has to identify potential tax evaders through other anti-tax evasion measures like the John Doe Summons.[1262] That generally means that any information the U.S. receives only corroborates the evidence the IRS has in its possession – it does not discover new evidence or the tax evaders themselves.[1263] Another hurdle that limits the TIEAs effectiveness is when a foreign jurisdiction has corporate laws that require little to no identification of shareholders or directors combined with a lack of recordkeeping, there is most likely little information to be handed over.[1264] Sometimes the limitations simply is that the partnering country might not have an adequate administration to exchange information or the banks just might not have the information to give.

8.5. ART. 26 & TIEAS: CONCLUSION

Art. 26 of the U.S. Model Income Tax Treaty and the Tax Information Exchange Agreements (TIEAs) are two more anti-tax evasion measures that the IRS can use to obtain information on U.S. taxpayers' foreign accounts.

Art. 26 of the U.S. tax treaty is the mechanism by which the U.S. and a foreign government can exchange information regarding taxation and the assessment, collection, administration of, enforcement of, or prosecution of matters regarding

[1261] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 422 (2010).
[1262] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 422 (2010).
[1263] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010).
[1264] Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States Settlement in the UBS Case*, 43 Cornell Int'l L. J. 409, 421 (2010).

taxes. Art. 26 obligates that the treaty partners obtain and provide information foreseeably relevant to taxes and the issues surrounding taxation such as enforcement and prosecution. It also requires that any information exchanged be kept secret and that it be disclosed only to relevant persons. A treaty partner cannot refuse to supply or exchange information based on the reasoning that the treaty partner has no domestic interest in the information or that the information is held by a financial institutions such as banks or other similarly situated persons or institutions. There is a limitation on art. 26 by not obligating the treaty partners to exchanging information that contravenes or is not obtainable under domestic laws. Art. 26 requires a certain form in which the information must be given in and this requirement aligns with U.S. domestic law. The information should be in the form of depositions and authenticated copies of original documents. The treaty partners are obligated to provide collection assistance and to allow the other treaty partner to enter the jurisdiction to interview witnesses and examine records. All of these provisions under art. 26 are there to facilitate the exchange of information between the U.S. and foreign governments.

The U.S. also uses tax information exchange agreements (TIEAs) to try to obtain information from jurisdictions that the U.S. does not have treaties with. A TIEA is more limited than a tax treaty as it is only used for the exchange of information.

While art. 26 can be an effective tool to obtain information on U.S. taxpayers' foreign accounts, it too, like the other measures, has limitations that keep it from being 100% successful.

How art. 26 of tax treaties and TIEAs are negotiated will either limit or enable the IRS to procure the information they need. If the Model Tax Convention that the U.S. uses as a starting pointing were, in fact, the final treaty between the U.S. and foreign governments, the U.S. would more than likely get the information it seeks regarding U.S. taxpayers' foreign accounts. However, foreign governments have their own interests, including bank secrecy (privacy) and, as the example of the U.S.-Swiss Treaty shows, relying on art. 26 of any given tax treaty does not necessarily mean the U.S. will be able to get the information it needs to administer its tax laws correctly

and fairly. Treaties work effectively when the treaty partners are two countries who have the same goals and same interests, but as seen above in the example of the U.S. – Swiss treaty, when two countries interests are not aligned there is bound to be failure because of the loopholes created in the treaty due to the imbalance of goals, interests and cultural differences. The imbalance is found when one country highly values the secrecy that protects the client's financial information from anyone, including the financial institution's government, but yet the information is needed to ensure that the citizen is not breaking the laws of their home country.

Another limitation that restricts art. 26's effectiveness to procure information on U.S. taxpayers' foreign accounts is the ability of the U.S. government to negotiate broad language that encompasses the definition of tax evasion as it is defined in the U.S. tax code. If broad language cannot be negotiated, then the IRS could potentially face a brick wall when it comes to trying to procure the information from its treaty partner regarding U.S. taxpayers' foreign accounts. Cultural differences in definitions of tax evasion and whether qualifies as a crime complicates the ability of the IRS to procure that information. The U.S.-Swiss Tax Treaty prior to the 2009 Protocol demonstrates this. While the ratification of the Protocol seems to have resolved the issues between the U.S. and Switzerland – whether the Protocol succeeds in allowing the U.S. to procure information on U.S. taxpayers' foreign accounts remains to be seen – the U.S. will face similar issues with other countries who value bank secrecy and where the current treaty's art. 26 is weak and does not allow for exchange of information on tax evasion.

Particular to the U.S.-Swiss Tax Treaty – through the 2009 Protocol update – is the compromise that was made regarding the broader language encompassing tax evasion and the request for information requirement. If the U.S. wants information on possible tax evasion going on in Switzerland by U.S. taxpayers, the U.S. is required to submit an information request. The first element of the requirement requires the U.S. to have information on a person but this has been a problem in the past either through art. 26 provisions or through TIEAs. When the IRS is confronted with information from a voluntary disclosure, for example, that a U.S. taxpayer has utilized the services of a

Swiss facilitator, there is some suspicion that this U.S. taxpayer is probably not the only taxpayer using these services. If the U.S. government wants to utilize art. 26 to procure information, they will have a potential problem because the IRS does not always have information on a person to give to fulfill this request so that Switzerland will turn over the information the IRS is seeking. However, the 2009 Protocol to the U.S. – Swiss Tax Treaty also demonstrates that even if the countries can agree to exchange information it does not mean there are not multiple procedural requirements to work through including the taxpayer right to appeal. The end result could still be that, despite fulfilling the obligations of art. 26, the IRS does not procure the information that it needs to administer the tax laws correctly and fairly.

The use of art. 26 (and the TIEAs) have limitations that do not allow the U.S. to obtain the information on U.S. taxpayers' foreign accounts every time. Obviously careful negotiation with attention being paid to the defining of tax evasion will resolve some of the issue. As was discussed in the body of this chapter, the U.S. is, and should, continue to try to strengthen its existing treaties and focus on art. 26 and well as strengthening its TIEAs with the countries it does not have a tax treaty with.

One issue that the U.S. government can resolve by itself is its willingness to trade information at the same level they expect of their treaty partners. They cannot expect the treaty partner to handover information on U.S. taxpayers' financial accounts if the U.S. is not willing to do likewise with the treaty partner's taxpayers. One criticism of the U.S. has been this very issue and it is exhibited in FATCA's (Foreign Account Tax Compliance Act, Chapter 9) Inter-governmental Agreements (IGA) that the U.S. does not exchange information equally with the IGA partner as the IGA partner is expected to disclose more information (See Chapter 9). This is some of the reason the U.S. has earned the designation of a tax haven.

The next chapter moves from using treaties and foreign governments to procure information on U.S. taxpayers' foreign accounts back to utilizing foreign financial institutions like it does with the Qualified Intermediary in Chapter 7. It also puts the focus back on the individual taxpayer as well. Chapter 9 will discuss and analyze the

Foreign Account Tax Compliance Act (FACTA) which is a tax regime that Congress passed to address the loopholes that exist in the previously discussed anti-tax evasion measures.

CHAPTER 9. FOREIGN ACCOUNT TAX COMPLIANCE ACT

9.1. INTRODUCTION

The previous five chapters have examined other anti-tax evasion measures that form the anti-tax evasion framework that is in place to allow the Internal Revenue Service (hereinafter referred to as IRS) to procure information on U.S. taxpayers' foreign accounts when secrecy laws prohibit the accessibility of this information. These measures use various methods to enforce compliance by U.S. taxpayers including summonses through the courts, voluntary compliance measures enforced through penalties, treaties with foreign governments and through foreign financial institutions. The chapters on those measures have demonstrated that none of the measures alone are successful in obtaining the information the IRS needs to administer the tax laws fairly and correctly. This is where the Foreign Account Tax Compliance Act (FATCA) comes in.

FATCA is considered as the anti-tax evasion measure that will solve the ability for the U.S. government to obtain information on U.S. taxpayers' foreign accounts. But is FATCA the answer to the issue of obtaining that information?

To discover the answer to that question, this chapter will first look to the legislative history to examine the purpose behind the enactment of FATCA and what led to the implementation of FATCA. Following the legislative section, the chapter will then examine the legal framework of FATCA and how it is implemented. Next, the chapter focuses on the Intergovernmental Agreements (IGAs) that were negotiated with foreign jurisdictions to assist in the implementation of FATCA due to FACTA's extraterritorial nature. Finally, the chapter considers two questions. First, does FATCA, when implemented, allow the U.S. government to obtain information on U.S. taxpayers' foreign accounts so that the IRS can administer the tax laws correctly and fairly? Second, if the answer to the first question is no, then what can be done to

improve FATCA so that it increases the likelihood of the IRS in obtaining the information needed to apply the tax laws correctly and fairly?

A quick note: FATCA contains many detailed definitions for terms found in the law and regulations. It distracts from the flow of the chapter and the explanation of how FATCA operates, therefore, in Appendix B there is a list of definitions applicable to this chapter so that the reader may refer to them.

9.2. INTRODUCTION TO FATCA

9.2.1. INTRODUCTION

This first section will consider FATCA, an anti-tax evasion framework, and what led to the implementation of FATCA. Tax evasion has been a century long problem – a problem that has existed almost as long as the U.S. tax system itself. One of the main problems of tax evasion from the U.S. government's perspective is the inability to procure information on U.S. taxpayers' foreign accounts so that the tax authority – the Internal Revenue Service (IRS) – can administer the law fairly and correctly with all the facts in front of them. Multiple factors – including the public outcry after the 2008 financial crisis and bank scandals – were the main motivators behind Congress ultimately enacting FATCA.[1265]

The UBS scandal, as noted throughout the thesis, seemed to be the tipping point in a decades-long battle against secrecy and tax evasion. Senator Carl Levin stated in his

[1265] John Paul, *The Future of FATCA: Concerns and Issues*, 37 N.E.J. Legal Stud. 52 (Spring/Fall 2018); *See also*, Melissa A. Dizdarevic, *The FACTA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 Fordham L. Rev. 2967, 2969 (May 2011); Joshua D. Odintz et al., *FATCA and Nonfinancial Entities: Practical Questions with Practical Answers*, 119 J. Tax'n 252 (December 2013); Martye Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?*, Bulletin for Int'l Tax'n 395, 396 (IBFD, August 2014); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 157-158 (Palgrave MacMillan 2nd ed., 2019); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 103 (Palgrave MacMillan 2013).

Senate floor remarks that the provisions in FATCA were part of the effort to stop offshore banks from utilizing the secrecy laws of their jurisdiction to assist in concealing U.S. taxpayers' assets which was a huge stumbling block that prohibited the correct and fair administration of the tax laws.[1266]

In 2003, the estimate of assets held in U.S. taxpayer-owned accounts at UBS was between $18-20 billion.[1267] UBS, as a financial institution incorporated in Switzerland, was subject to the U.S.-Swiss Treaty – including the 2003 agreement – and the Qualified Intermediary Program.[1268] The UBS scandal demonstrates that despite the other measures being in place, UBS was still able to help conceal U.S. accounts from the U.S. government. Congress realized some other legal measure needed to be in place to enforce compliance by the taxpayers and the foreign financial institutions.

Sean Deneault argues that prior to FATCA, the U.S. had attempted several times, successfully, at reigning in the banks that facilitated tax evasion.[1269] However, if they were wholly successful, FATCA would not have been enacted in order to address the shortcomings of prior attempts like the Qualified Intermediary because financial institutions like UBS would not have had blatantly ignored their responsibilities to report U.S. accounts. In fact, Deneault argues in the same article that the IRS "*historically had little success*" in locating offshore income and notes that the primary reason is because the FFIs failed to report the information.[1270] While this is true, the blame cannot be placed solely on the shoulders of the FFIs – the U.S. taxpayers' own some of the blame for not voluntarily disclosing. FATCA addresses both the FFI and

[1266] 111th Cong., S. Rep. No. 111-156 at 3806 (March 18th, 2010).
[1267] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 739 (2014).
[1268] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 739 (2014).
[1269] John Paul, *The Future of FATCA: Concerns and Issues*, 37 N. E. J. Legal Stud. 52, 53-54 (Spring/Fall 2018).
[1270] John Paul, *The Future of FATCA: Concerns and Issues*, 37 N. E. J. Legal Stud. 52, 53-54 (Spring/Fall 2018); *See also*, Joshua D. Odintz, Michelle R. Phillips, Rodney W. Read & Mireille R. Zuckerman, *FATCA and Nonfinancial Entities: Practical Questions with Practical Answers*, 119 J. Tax'n 252 (December 2013).

the U.S. taxpayer and both have consequences under FATCA for not reporting. Another scholar, James F. Kelly, supported this as well, stating that "*Absent the role of UBS in the deferred prosecution agreement, it is plausible there would not have been the political will to upset what seemed like an impenetrable foreign banking system*."[1271] Essentially, FATCA exists because of the political pressure received from fed-up U.S. voters after the financial crisis and the banks scandals – this is what fired up the "*political will*" for Congress to enact FATCA.[1272]

The measures that were examined in Chapters 4-8 did not provide the amount of information, knowledge or compliance that the U.S. government had hoped for.[1273] The U.S. government needed a measure that would be effective in forcing both the foreign financial institutions and taxpayers to comply. But this measure, unlike a few of the other anti-tax evasion measures, needed to a big stick to "encourage" the FFIs and taxpayers to comply.

9.2.2. LEGISLATIVE HISTORY

This section will examine the legislative history behind the Foreign Account Tax Compliance Act and the reasons behind its enactment.

The history of U.S. tax law demonstrates that since the inception of the 16th amendment (and possibly well before that) U.S. taxpayers have utilized jurisdictions with secrecy or strong privacy laws to conceal their accounts from the U.S. government. Despite having numerous other measures (Chapters 4-8) whose purpose is to help the U.S. government procure information on U.S. taxpayers' foreign

[1271] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 989 (2016-2017).
[1272] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 103 (Palgrave MacMillan 2013).
[1273] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 734-735 (2014).

accounts, U.S. taxpayers were still able to conceal their foreign accounts. UBS and the other bank scandals were proof of that.

Multiple investigations and hearings were held and reports issued on the problem of secrecy and the inability to obtain taxpayer information on foreign accounts.[1274] Congress, based on the evidence that was illustrated in the investigations, hearings and reports, was concerned with both the estimated $100 billion annual loss in tax revenue[1275] and frustrated with the lack of success of the prior measures in increasing compliance among U.S. taxpayers with foreign accounts.[1276]

Congress – confronted with the compliance issue – realized that where the domestic third-party reporting regime encouraged compliance at home, the same could not be said regarding U.S. taxpayer compliance abroad.[1277] There was no international third-party reporting regime in place to elicit that compliance.[1278] Legislative history confirms that for at least some legislators, FATCA was about *"cracking down on*

[1274] William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-6 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[1275] U.S. Senate Permanent Subcommittee on Investigations, *Offshore Tax Evasions: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts*, Homeland Sec. & Governmental Affairs Permanent Subcommittee on Investigations (2008), *available at* http://hsgac.senate.gov/subcommittees/investigations/hearings/offshore-tax-evasion-the-effort-to-collect-unpaid-taxes-on-billions-in-hidden-offshore-accounts ; *see also,* Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism,* 21 ILSA J. Int'l & Comp. Law 333 (Spring 2015)*;* U.S. Senate Permanent Subcomittee on Investigations, Committee on Homeland Security and Governmental Affairs Staff Report, *Tax Haven Banks and U.S. Tax Compliance*, 17 (July 2008); James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 989 (2016-2017).

[1276] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism,* 21 ILSA J. Int'l & Comp. Law 333, 337 (Spring 2015); *See also*, James F. Kelly, *International Tax Regulation by United States Fiat: How FATCA Represents Unsound International Tax Policy,* 34 Wis. Int'l L. J. 981, 985 (2016-2017).

[1277] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism,* 21 ILSA J. Int'l & Comp. Law 333, 337 (Spring 2015).

[1278] Bruce W. Bean and Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperalism,* 21 ILSA J. Int'l & Comp. Law 333, 337 (Spring 2015).

overseas tax havens"[1279] and stopping "*offshore banks from using secrecy laws to help U.S. taxpayers evade their taxes*"[1280].

The enactment of FATCA was not an expeditious triumph that some Congressmen were hoping for considering it took multiple attempts over numerous years.[1281] FATCA was originally a stand-alone bill that was introduced into both the House and the Senate in 2009.[1282] The bill under the Hiring Incentives to Restore Employment Act (HIRE act) was a bilateral collaboration between the House and the Senate and supported by both the President and the Treasury Department.[1283] When FATCA was finally passed, FATCA was not its own bill but, instead, was part of the HIRE Act that added Chapter 4 – sections §1471 – 1474 – to the Internal Revenue Code. The HIRE Act's goal was to improve the state of the economy within the U.S by functioning as an additional tax revenue source.[1284] FACTA is not an official name of an act found in the United States Code (USC).[1285] That bill died in committee and was never voted on. The portion of the Hire Act that added Chapter 4 to the USC has is now known colloquially as FATCA among the legal community worldwide and even the IRS themselves.[1286] The purpose of the HIRE bill – as stated in both the text of the dual bills introduced as well as introductory remarks in front of the Senate – is

[1279] 111th Cong., H.R. Rep. No. 111-156 at 1152 (2010).
[1280] 111th Cong., S. Rep. No. 111-156 at 1745 (2010).
[1281] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 985 (2016-2017).
[1282] Foreign Account Tax Compliance Act, H.R. 3933, 111th Cong. (2009); *See also*, James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 988 (2016-2017).
[1283] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 988 (2016-2017).
[1284] Scott D. Michel & H. David Rosenbloom, *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?*, Viewpoints, Tax Analysts, 709 (May 30, 2011); *See also* William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-4 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119; Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 735 (2014); Alicja Brodzka, *FATCA From the European Union Perspective*, 2 J. Gov. & Reg. Issue 3, 7 (2013).
[1285] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 103 (Palgrave MacMillan 2013).
[1286] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 103 (Palgrave MacMillan 2013).

to prevent the avoidance of income tax on assets that are held in foreign accounts.[1287] Hearings that proceeded the passage of FATCA and that discussed the legislation confirm that the purpose behind the bill was to address deliberately undisclosed foreign financial accounts held by U.S. taxpayers and, further, that FATCA focuses on the financial institutions instead of specific countries.[1288]

William J. Wilkins, Chief Counsel of the IRS at the time, testified that the overall goal of FATCA was to compel U.S. taxpayers to report global income in order to curtail both intentional tax avoidance and illegal tax evasion.[1289] The concern was that U.S. taxpayers were able to intentionally avoid reporting worldwide income made on their indirect foreign investments held in foreign entities because foreign financial institutions did not have an "*obligation to report the non-U.S. source income of a U.S. customer that is not paid within the United States"* which is how UBS helped many U.S. taxpayer avoid detection – hiding behind foreign entities.[1290] Another concern was that a foreign corporation had no obligation to file a Form 1099, backup-withhold or comply with withholding rules that applied to U.S. persons generally even if the

1287 Foreign Account Tax Compliance Act, H.R. 3933,111th Cong. (2009); *Foreign Account Tax Compliance Act*, S. 1934, 111th Cong. (2009).
1288 U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance* at 20 (2009) (Statement of William J. Wilkins, Chief Counsel, IRS)*available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/CHRG-111hhrg63014/context; *See also*, D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 314 (Palgrave MacMillan 2016).
1289 Alicja Brodzka, *FATCA From the European Union Perspective*, 2 J. Gov. & Reg. Issue 3, 7 (2013); *See also*, William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-6 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119
1290 U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance*, 16 (2009) (Statement of William J. Wilkins), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/context; *See also*, William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-6 & 1-7 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

foreign entity was owned by a U.S. taxpayer because the beneficial owner was identified as a foreign entity, not the U.S. person – also a strategy of UBS.[1291]

According to the U.S. Treasury, the policy goal of FATCA is not to collect the withholding tax - the enforcement mechanism for FATCA but is to achieve reporting of foreign accounts that are held by U.S. taxpayers.[1292] This confirms the assertion that the purpose for FATCA was to circumvent the secrecy laws of other countries to procure information on U.S. taxpayers' foreign accounts.

9.3. IMPLEMENTATION OF FATCA

9.3.1. HOW DOES FATCA OPERATE?

This section examines and analyzes how FATCA is implemented as a measure to procure information on U.S. taxpayers' foreign accounts despite the hindrance that secrecy laws provide. It discusses in detail the inner workings of FATCA and what is required now of both FFIs and U.S. taxpayers themselves.

As discussed above, FATCA was designed to peel back the veil of bank secrecy and procure information on U.S. taxpayer foreign accounts by extending the IRS' influence beyond the U.S.' own borders through the enforcement of a withholding penalty. This set of statutes and regulations that make up Chapter 4 withholding is a

[1291] U.S. House Subcommittee on Select Revenue Measures of the Committee on Ways and Means, *Foreign Bank Account Reporting and Tax Compliance,*16 (2009) (Statement of William J. Wilkins), *available at* https://www.govinfo.gov/app/details/CHRG-111hhrg63014/context; *See also,* William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, p. 1-7 (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119

[1292] U.S. Treasury Department, Joint Statement From The United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA, 1 (2012), *available at*, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf; *See also,* D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 315 (Palgrave MacMillan 2016).

more complex framework than the QI statutes and regulations despite some simplifications that have taken place over the years.[1293] Fulfilling the multiple objectives of FATCA is accomplished in one of three ways: 1) identifying and documenting U.S. taxpayer-held accounts, 2) reporting on those accounts and 3) requiring the individual taxpayer to report on their foreign-held accounts. These objectives are backed up by an 30% penalty – or enforcement mechanism as the IRS likes to describe it. This anti-tax evasion measure comes at solving the issue – procuring information – on two fronts: FFIs and U.S. taxpayers.

An important distinction to remember in this chapter is that FATCA is Chapter 4 withholding while the QI regulations (Chapter 7) refer to Chapter 3 withholding.[1294] What is the difference exactly? The Chapter 4 withholding framework deals with ANY income – from either a U.S. or foreign source – paid to a U.S. person in an account held outside the U.S.[1295] In contrast, the Chapter 3 withholding framework deals with U.S.-sourced FDAP (fixed, determinable, annual and periodic) income that is paid to foreign recipients. But there are places where the two converge: reliance on KYC and AML procedures for the due diligence requirement, the use of the W-8/W-9 forms to identify account holders and the use of forms 1042, 1042S and 1099 to report income.[1296] FATCA's, or Chapter 4 withholding, system is reflective of the system in Chapter 3, or QI regulations, in that the intermediaries in the chain have to identify themselves and their FATCA status to their counterparties using Form W-8IMY to report it.[1297]

[1293] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 122 (Palgrave MacMillan 2013).
[1294] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).
[1295] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 101 (Palgrave MacMillan 2013).
[1296] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 122 (Palgrave MacMillan 2013).
[1297] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).

There are three main objectives that make up FATCA's foundation: Documentation, Reporting and Withholding.[1298] These principles work in concert together in the following way: 1) the foreign financial institution has to document and identify any U.S. owners in their customer base using due diligence, 2) after identifying and documenting, the FFI has an obligation to annually report on U.S.-owned accounts held at the FFI and 3) the 30% withholding is applied to address either recalcitrant[1299] owners who refuse to identify themselves or against U.S.-source payments made to the FFIs who are non-compliant. These prongs create the basic structure of FATCA which will be discussed in more detail in the following sections.

Before the chapter gets down in the weeds to really explain how FATCA operates, the big picture needs to be filled in. Under the statutes and regulations that are now known as FATCA, FFIs were required to enter into a cooperative agreement with the IRS known as the FFI Agreement (26 C.F.R. §1.1471-4) so that the FFIs could identify any Americans among its client base and to disclose certain information about those American clients.[1300] The FFI agreement allows the FFIs to avoid Chapter 4 withholdable payments and pass-thru payments as long as they undertake due diligence in their documentation and identification, information reporting and withholding obligations.[1301] The problem began when the FFIs found that there were multiple reasons that they could not comply with FATCA - the chief reason was that

[1298] 26 U.S.C. §1471 and §1472; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA,* 114 (Palgrave MacMillan 2013).
[1299] A recalcitrant owner is an account holder that has not provided the FFI with the information that it requested so that the FFI can determine the owner's Chapter 4 (FATCA) status – U.S. Person or not.
[1300] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law*, 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).
[1301] IRS Rev. Proc. 2017-16; *See also*, Marin Michaels, *International Taxation: Withholding,* ¶6.06 (September 2018).

complying with FATCA might violate their own country's laws.[1302] The Department of the Treasury, in order to address these concerns, worked together with multiple governments and from this effort, the Intergovernmental Agreements were born (hereinafter referred to as IGAs).[1303] (The IGAs will be discussed in more detail in Section 9.4).

So how does an FFI comply with FATCA? It depends upon the IGA that their nation has adopted.[1304] The choice of IGA provides the means by which the FFIs can comply with FATCA without contravening their own nations' laws.[1305] Nations choose either Model 1 or Model 2 (which has significance which will be discussed in Section

[1302] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1303] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1304] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1305] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

9.4).[1306] So, for example, Switzerland executed a Model 2 IGA so their banks would follow the procedures and practices set forth under the U.S.-Switzerland Model 2 IGA, but Denmark executed a Model 1 IGA so Danish financial institutions would follow the U.S.-Denmark Model 1 IGA procedures and practices. Model 1 FFIs have to register with the IRS but do not have an FFI Agreement. They follow the practices set out in the Model 1 IGA and are not subject to withholding and reporting requirements as long as they are in compliance.[1307] Model 2 FFIs follow an FFI Agreement that is modified by the Model 2 IGA that their government executed.[1308]

Based on the above information, the next few sections will describe the FATCA procedures followed in the Model 1 and 2 IGAs considering these are the predominant procedures and practices as well the FFI regulations (FFI Agreement). The key difference in Model 1 and Model 2 is that after the information is gathered by the FFI, in Model 1 the FFIs relay the information to their government which then relays the information to the IRS.[1309] In contrast to Model 1, Model 2 FFIs, directly relay their information to the IRS.[1310] Any other differences will be noted where applicable.

[1306] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1307] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1308] Alexander Szwakob, *Foreign Account Tax Compliance Act: The Most Revolutionary Piece of Tax Legislation Since the Introduction of the Income Tax,* UConn Theses, 12 (Fall 2015), *found at* https://opencommons.uconn.edu/cgi/viewcontent.cgi?article=1472&context=srhonors_theses; John Wisiackas, *Foreign Account Tax Compliance Act: What It Could Mean for the Future of Financial Privacy and International Law,* 31 Emory Int'l L. Rev. 585 (2017); Marin Michaels, *International Taxation: Withholding,* ¶6 (September 2018).

[1309] Model 1 and 2 Intergovernmental Agreements

[1310] Model 1 and 2 Intergovernmental Agreements

9.3.1.1 Documentation, Identification and Due Diligence[1311]

Chapter 4's (FATCA) reporting system reflects that of Chapter 3's reporting system in that all intermediaries in the chain have a duty to identify themselves and their FATCA status to the other links in the chain.1312 This first prong of FATCA is the most complex of the law but the information obtained directs the reporting and withholding prongs. All FFIs, including Model 1 and Model 2 FFIs, are required to document, identify and employ due diligence to complete the documentation and identification process.

The first question this section is what is an intermediary? An intermediary is *"with respect to a payment that it receives, a person that, for that payment, acts a custodian, broker, nominee, or otherwise as an agent for another person, regardless of whether such other person is the beneficial owner of the amount paid, a flow-through entity, or another intermediary*."1313 A foreign financial institution (hereinafter FFI) is considered an intermediary because it acts as the custodian for the beneficial owner and would have the documentation and knowledge on said owner.1314 The QI chapter (7) alluded to the idea that Chapter 4 FFIs, while similar to those of Chapter 3, involve a much broader category of FFIs. Therefore, the more correct question is what is an FFI under Chapter 4 reporting? A simple definition is that an FFI engages in accepting deposits, holds financial assets for the account of others which makes up a substantial part of its business or it is in the business of investing.1315 But the FFI, under FATCA, is not only the definition above but includes a new concept that encompasses both traditional financial service intermediaries such as bankers and brokers as well

[1311] 26 U.S.C. §1471; *See also*, Model 1 and 2 Intergovernmental Agreements
[1312] Ross K. McGill, U*.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).
[1313] 26 C.F.R. §1.1441-1(c)(13)
[1314] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).
[1315] See Appendix B for a more detailed definition.

as, according to Ross McGill, collective investment vehicles.1316 This is an accurate description because understanding what qualifies as an FFI under FATCA is crucial because it identifies the FFIs that have Chapter 4 documenting, reporting and withholding obligations. The definition under FATCA was kept purposefully broad to include "*almost all institutions that could aid a U.S. citizen in evading taxes.*"1317 Sean Deneault calls the definition of an FFI the "gatekeeper" definition.1318.

9.3.1.1.1 U.S. Indicia

One of the most important purposes that FFIs have under FATCA is in the identification of any account that contains U.S. indicia that indicates that the account under review is owned by a U.S. person. This determines both the reporting and withholding responsibilities of the FFI. This purpose is also important in relation to the thesis issue. When a FFI discovers U.S. indicia on an account and if through due diligence they prove it is, in fact, a U.S.-held account, then the reporting objective should lead to the IRS receiving the information needed to ensure the tax laws (withholding for example) are being carried correctly and fairly. First, the FFI needs to identify the beneficial owner of a payment and the status of the payee of that payment – are they a U.S. person or a non-U.S. person?[1319] This determination comes from the reliable information that the withholding agent can reasonably associate with the payment.[1320]

A U.S. person can include a U.S. citizen, a U.S. resident (based on a residency test), corporations and partnerships created or organized under the laws of the U.S., estates subject to U.S. income tax and certain types of trusts.[1321] When the FFI is identifying

[1316] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).
[1317] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014).
[1318] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 744 (2014).
[1319] Marin Michaels, *International Taxation: Withholding*, ¶6.05 (September 2018).
[1320] Marin Michaels, *International Taxation: Withholding*, ¶6.05 (September 2018).
[1321] 26 U.S.C. §7701; *See also*, Marin Michaels, *International Taxation: Withholding*, ¶6.01 (September 2018).

U.S. persons that are in their client database, they are required to look for U.S. indicia. This could be anything from a U.S. telephone number to a U.S. passport. However, a FFI would do well to remember that U.S. indicia are not always obvious – a U.S. person is not always a passport-carrying or birth certificate-holding American.[1322] A U.S. person, for U.S. tax purposes, can include a foreign person who once held a U.S. green card but never revoked it or a child born in a foreign jurisdiction who has at least one U.S.-born parent.[1323] Some of these persons are not even aware that they are U.S persons under U.S tax law, and more specifically, FATCA.[1324]

Any person that does not fall under the definition of a U.S. person is a non-U.S. person.[1325] This is an important distinction because it tells the FFI (and others) whether the person is subject to Chapter 3 or 4 withholding.[1326] As explained in Chapter 7 (Chapter 3 Withholding/QI), non-U.S. persons are only subject to U.S. federal income tax on U.S.-source FDAP income or income related to business dealings in the U.S.[1327]

Identifying exactly who is a U.S. person is important because the FFIs are required to document and identify U.S. persons in order to be able to correctly withhold and report on U.S.-held accounts.[1328] If all done correctly, then the IRS should receive the information on U.S.-held accounts they need to apply the tax laws correctly and fairly.

[1322] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 147 (Palgrave MacMillan 2013).
[1323] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 147 (Palgrave MacMillan 2013).
[1324] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 147 (Palgrave MacMillan 2013).
[1325] 26 U.S.C. §7701; See also, Marin Michaels, *International Taxation: Withholding*, ¶6.01 (September 2018); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).
[1326] 26 U.S.C. §7701; See also, Marin Michaels, *International Taxation: Withholding*, ¶6.01 (September 2018); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 142 (Palgrave MacMillan 2013).
[1327] 26 U.S.C. §7701; *See also*, Marin Michaels, *International Taxation: Withholding*, ¶6.01 (September 2018).
[1328] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 147 (Palgrave MacMillan 2013).

The regulations lay out the U.S. indicia for individual and entity accounts.[1329] Just because U.S. indicia are found does not equate to the account being a U.S.-held account. It means the FFI has to dig deeper using due diligence to decide if their client is a U.S. person.[1330] This is discussed further in subsection 9.3.1.2.

9.3.1.1.2 Documentation and Identification Process

Once the FFI has completed its search for U.S. indicia, the next few steps are to document what is found and identifying the U.S. person if indicators are found. What does Chapter 4 documentation and identification look like? As noted above, the FFI needs to search their database of customers for any indication of U.S. ownership of an account. In order to identify U.S. account holders, FFIs are required to use due diligence procedures[1331] mapped out in the applicable IGA annex.[1332]

The identification and documentation procedures for U.S. accounts depends on whether it is held by an individual or an entity and whether it is a pre-existing or new account.[1333] This is broken down even further into the difference between the value of the account – low value versus high value accounts.[1334] Low value accounts represent less risk for tax evasion than do high risk accounts for obvious reasons.

For pre-existing accounts that have a balance of at least $50,000 but less than $1 million ("lower value accounts"), the FFIs are only required to search only their electronic records for U.S. indicia. Accounts that are less than $50,000 USD, they

[1329] 26 C.F.R. §1.1471-4 (c)(5)(iv)(B); *See also*, 26 C.F.R. §1.1471-4 (c)(3); 26 C.F.R. §1.1471-3 (b) – (d); Intergovernmental Agreements Models 1 & 2, Annex I, art. 2, para. B, subsection 1 and art. 4, para. D
[1330] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, (Palgrave MacMillan 2019).
[1331] Further discussion on due diligence found in subsection 9.3.1.1.5
[1332] 26 U.S.C. §1471 (b)(1)(B); *See also*, Models 1 and 2 IGA, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx
[1333] 26 C.F.R. §1.1471-3.
[1334] Intergovernmental Agreements 1 & 2, art. 2.

are not required to be reviewed as a U.S reportable account because the risk of tax evasion is low.[1335]

The indicators of U.S. ownership that the FFI is to scan for are:

a) Identification of the account holder as U.S. citizen or resident;
b) Unambiguous indication of a U.S. place of birth;
c) Current U.S. mailing or residence address (including a U.S. post office box);
d) Current U.S. telephone number;
e) Standing instructions to transfer funds to an account maintained in the United States;
f) Currently effective power of attorney or signatory authority granted to a person with a U.S. address; or
g) An "in-care-of" or "hold mail" address that is the *sole* address the Reporting Financial Institution has on file for the Account Holder.[1336]

If any of the indicia are found in the electronic files, then the account will be treated as a U.S. account and no further examination will be needed.[1337] There are exceptions to this where the FFI is not required to treat the account holder as a U.S. person, for example, where an account holder gives the U.S. as the unambiguous place of birth but has given the FFI a self-certification that the account holder is not a U.S. citizen, a copy of a non-U.S. passport and a copy of the certificate of loss of U.S. nationality.[1338] An example of this would be a former U.S. citizen who gave up their U.S. citizenship and is a citizen of a foreign country and holds an account in a financial institution in that foreign country.

[1335] Intergovernmental Agreements 1 & 2, art. 2, para A.
[1336] 26 C.F.R. §1.1471-4 (C)(5)(iv)(A); *See also,* Inter-governmental Agreement Models 1 & 2, Annex I, art. 2, para B, subsection 1.
[1337] Intergovernmental Agreement Models 1 & 2, Annex I, art. 2, para B, subsection 1 & 2.
[1338] 26 C.F.R. §1.1471-4 (B)(2)(ii); *See also,* Intergovernmental Agreement Models 1 & 2, Annex I, art. 2, para. B, subsection 4(a).

Pre-existing accounts that are in excess of $1 million USD ("high value"), require enhanced review procedures because these are the accounts that the IRS believes is where tax evasion is more likely to occur.[1339] These high value accounts require both electronic and paper searches for U.S. indicia (enhanced review) using the same indicia as the lower value accounts.[1340] The limitation, where an enhanced review of a high value account is not needed, is that an electronic search may be relied on if the search includes the following:

a) The account holder's nationality or residence status;
b) The account holder's residence address and mailing address currently on file with the RFI;
c) The account holder's telephone number(s) currently on file, if any, with the RFI;
d) Whether there are standing instructions to transfer funds in the account to another account;
e) Whether there is a current "in-care-of" or "hold mail" address for the account holder; ***and***
f) Whether there is any power of attorney or signatory authority for the account.[1341]

How are new accounts for individuals managed when looking for U.S. indicia? New accounts are accounts that are opened after the determination date and are to be reviewed at the time of opening.[1342] The FFI must obtain a self-certification that allows the FFI to determine whether the account holder is a U.S. resident (for tax purposes).[1343] The FFI is to confirm the reasonableness of the self-certification based

[1339] 26 C.F.R. §1.1471-4 (c)(5)(iv)(D)(2); *See also*, Intergovernmental Agreements 1 & 2, Annex I, art. 2, para D.
[1340] Intergovernmental Agreements 1 & 2, Annex I, art. 2, para D, subsection 1 and 2.
[1341] 26 C.F.R. §1.1471-4 (c)(5)(iv)(D)(4)(i)-(vi); *See also*, Inter-governmental Agreement Models 1 & 2, Annex I, art. 2, para D, subsection 3(a)-(f).
[1342] 26 C.F.R. §1.1471-4(c)(4); *See also*, Intergovernmental Agreement Models 1 & 2, Annex I, art. 3, para. B.
[1343] 26 C.F.R. §1.1471-4(c)(4); *See also*, Intergovernmental Agreement Models 1 & 2, Annex I, art. 3, para. B.

on the information obtained by the FFI.[1344] This includes any information that has been gained and collected pursuant to the FFI's Anti-Money Laundering (AML) or Know-Your-Customer (KYC) initiatives.[1345] The new account exceptions are depository accounts and cash value insurance contracts[1346] under $50,000 which do not need to be reported.[1347] The determination date is defined as "*the date on which the Treasury Department determines not to apply withholding under section 1471 of the U.S. Internal Revenue Code to [FATCA Partner] Financial Institutions*."[1348] That date is determined, according to the definition found in both annexes, based on either June 30, 2014 when an agreement was reached on or before that date, November 30, 2014 when an agreement was reached between July 1, 2014 and November 30, 2014, or the date of signature of the agreement in the case of any other jurisdiction.[1349]

The other type of accounts that are to be examined for U.S. indicia are accounts held by entities – both pre-existing and new accounts.[1350] In order to ascertain whether a pre-existing account that is held by an entity should be reviewed or not,[1351] art. 4 in the annexes lays out the procedure. If a pre-existing entity account does not exceed $250,000 (as of June 30, 2014), the FFI is not required to review, identify, or report the account as a U.S. reportable account.[1352] This does not happen until the value of the account is over $1,000,000 (once again, high value account, more risk for tax evasion).[1353]

An entity account that should be reviewed are accounts whose balance 1) "*exceeds $250,000 as of June 30, 2014, and 2) a Preexisting Entity Account that does not*

[1344] Intergovernmental Agreement Models 1 & 2, Annex I, art. 3, para. B.
[1345] Intergovernmental Agreement Models 1 & 2, Annex I, art. 3, para. B.
[1346] This is a type of insurance that allows the insured to build up savings because the premium is more than just the mortality cost. It is a type of permanent or whole life insurance that combines a savings (or investment) feature and a insurance.
[1347] Intergovernmental Agreement Models 1 & 2, Annex I, art. 3, para. A.
[1348] Intergovernmental Agreement, Models 1 & 2, Annex I, art. 4, para. B, subsection 6.
[1349] Intergovernmental Agreement, Models 1 & 2, Annex I, art. 4, para. B, subsection 6.
[1350] 26 C.F.R. §1.1471-4 (c)(3)(i)-(c)(4).
[1351] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para A.
[1352] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para A.
[1353] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para A.

exceed $250,000 as of June 30th, 2014 but the account balance or value of which exceeds $1,000,000 as of the last day of 2015 or any subsequent calendar year" is required to be reviewed with the procedure laid out in paragraph D.[1354] Preexisting entity accounts that are required to be reported are accounts that are held by one or more entities that are specified-U.S. persons or passive Non-Financial Foreign Entities (NFFEs) with one or more controlling persons who are U.S. citizens or residents.

When the FFI is trying to determine which preexisting entity accounts should be identified and reported, art. 4, paragraph D lays out the procedure.[1355] The FFI has four categories to examine in order to make the determination:

1) Determine Whether the Entity is a Specified U.S. Person.
2) Determine Whether a Non-U.S. Entity is a Financial Institution.
3) Determine Whether a Financial Institution is a Non-Participating Financial Institution Payments to Which are Subject to Aggregate Reporting Under Subparagraph 1(b) of Article 4 of this Agreement.
4) Determine Whether an Account Held by an NFFE is a U.S. Reportable Account.[1356]

If any U.S. indicia is found in any of the accounts, individual or entity, then the accounts should be treated as a U.S. reportable accounts unless an exception applies.[1357]

[1354] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para B.
[1355] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para D.
[1356] Inter-governmental Agreement Models 1 & 2, Annex I, art. 4, para D.
[1357] Intergovernmental Agreements 1 & 2, Annex I, art. 2.

The next section briefly discusses the documentary evidence that a withholding agent is allowed to rely upon in order to determine a person's Chapter 4 status (U.S. person versus non-U.S.).[1358]

9.3.1.1.3 Documentary Evidence

What documentary evidence can a withholding agent rely on that will establish a person's Chapter 4 status? Under both models of the IGAs, acceptable documentary evidence is any of the following:

a) A certificate of residence that has been issued by an authorized governmental body (for example, tax authority) of the jurisdiction in which the payee claims to be a resident;
b) Individuals: Any valid ID issued by an authorized government body that includes the individual's name and is used for ID purposes;
c) Entities: Any official documentation issued by an authorized government body that includes the name of the entity and either the address of its principal office in the jurisdiction in which it claims to be a resident or the jurisdiction in which the entity was incorporated or organized;
d) Financial Account that are in approved AML jurisdictions: any documents, other than a Form W-8 or W-9, referenced in the jurisdiction's attachment to the QI agreement for identifying individuals or entities; or

[1358] 26 C.F.R. §1.1471-1(b)(32)

e) Any financial statement, third-party credit report, bankruptcy filing or U.S. Securities and Exchange Commission.[1359]

Documentary evidence does not include a withholding certificate or a written statement (that provides the persons Chapter 4 status).[1360]

9.3.1.1.4 Standards of Knowledge

The FFI is held to a certain standard of knowledge when it relies on documentation that is collected in the process of due diligence. The standards of knowledge are the "*reason to know*" and the "*actual knowledge*" standards also found in the Chapter 3 regulations (QI).[1361] Once the FFI has reason to know that the documentation that it has in its possession is unreliable or incorrect, it cannot rely on the documentation and new valid documentation from the client has to be obtained.[1362] Reason to know is defined as "*information indicating that a claim is unreliable or incorrect if all relevant facts or statements in the withholding certificates or the documentation are such that a reasonably prudent person in the position of a withholding agent would question the claims made."*[1363]

If new valid, authenticating documentation cannot be obtained identifying whether the account holder is a U.S. person, then the account should be treated as a non-consenting U.S. Account (or recalcitrant).[1364] The actual knowledge standard applies when the account has a relationship manager (usually a high value account) and that

[1359] 26 C.F.R. §1.1471-3 (c)(5)(i)-(ii); *See also*, Intergovernmental Agreements Models 1 & 2, Annex I, art. 6, para D.
[1360] 26 C.F.R. §1.1471-3 (c)(5)(i)-(ii); *See also*, Intergovernmental Agreements Models 1 & 2, Annex I, art. 6, para D.
[1361] 26 C.F.R. §1.1471-4(c)(2)(ii); *See also*, Intergovernmental Agreements Models 1 & 2, Annex I, art. 5, para A; Marin Michaels, *International Taxation: Withholding*, ¶6.05 (September 2018).
[1362] 26 C.F.R. §1.1471-4 (c)(2)(ii); *See also*, Intergovernmental Agreement Models 1 & 2, Annex I, art. 5, para. A.
[1363] Marin Michaels, *International Taxation: Withholding*, ¶6.05 (September 2018).
[1364] 26 C.F.R. §1.1471-4(c)(2)(iii)(C); *See also*, Intergovernmental Agreements Models 1 & 2, Annex I, art. 3, para. B, subsection 2.

relationship manager has actual knowledge that the account is a U.S. account.[1365] Actual knowledge is defined as "*direct and clear cognizance of a circumstance or a fact, resulting from information that would lead a reasonable, prudent person to investigate further*."[1366]

If there are changes to the circumstances of the account, there must be procedures implemented so that the account manager that maintains the relationship with the account, can identify those changes and obtain appropriate documentation from the account holder to either identify the account holder as a U.S. owner or rule the account out as being U.S.-owned.[1367]

9.3.1.1.5 Due Diligence

Due diligence in an important concept in both Chapters 3 and 4 reporting. It is the standard that FFIs are held to when identifying and documenting potential U.S. account holders. Identification and documentation are due diligence on the part of the FFI. The due diligence obligation that FATCA puts on the FFIs is the process detailed above: identification and documentation. The due diligence process is described in two places – either the Inter-Governmental Agreement and the attached Annex I or relevant U.S. Treasury Regulations.[1368]

The Annexes to the Inter-Governmental Agreements (which will be discussed in section 9.4) breaks down the due diligence required by the FFIs with respect to accounts in a couple of ways. One way it categorizes the due diligence required for accounts is by identifying those accounts that need to be reported and those that are not required to be reported. Model 2 IGA FFIs are required to use the due diligence procedure laid out in the Annex of the Model 2 IGA unless they choose to use the due

[1365] 26 C.F.R. §1.1471-4 (c)(5)(iv)(D)(2); *See also,* Intergovernmental Agreements 1 & 2, Annex I, art. 2, para. D, subsection 4.
[1366] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 56 (Palgrave MacMillan 2019).
[1367] 26 C.F.R. §1.1471-4 (c)(2)(iii); *See also,* Intergovernmental Agreements 1 & 2, Annex I, art. 2, para. E, subsection 5.
[1368] Inter-governmental Agreement Model 1, Annex I, para. C.

diligence procedures that are outlined in the FFI agreement which follows the regulations' due diligence procedures.[1369]

The due diligence requirements are vast and extensive. They are reflective of the issues and gaps that have been found within the law and other measures taken, like the QI, to procure information on the foreign financial institution's U.S. customers.

9.3.1.2 Reporting

The starting point is that Americans are supposed to have voluntarily reported their non-U.S. accounts but when they have not complied, the reporting from FATCA (and other anti-tax evasion measures as well) provides the IRS information that they might not otherwise have. Reporting is the main focus of FATCA because FATCA is a reporting framework.[1370]

The reporting objective of FACTA requires the FFI to relinquish to the IRS certain information regarding financial accounts that are held by U.S taxpayers that have material ownership in the account.[1371] The purpose of this is to create *transparency* where there might not be any or to make it easier for the IRS to procure information that would not be easily attainable otherwise. In order to achieve this goal of transparency via forced compliance, three types of business structures enter into disclosure agreements with the IRS. These three types are foreign financial institutions, foreign companies with substantial U.S. ownership and pass-thru companies.[1372] This agreement requires three actions of the FFIs once they enter into

[1369] Marin Michaels, *International Taxation: Withholding*, ¶6.05 (September 2018).

[1370] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 177 (Palgrave MacMillan 2019).
[1371] David Gannaway, *Key Provisions of the Foreign Account Tax Compliance Act*, 39 Est. Plan. 35 (September 2012).
[1372] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 743 (2014).

an FFI agreement with the IRS.[1373] Those actions consist of due diligence (identification and documentation), annual reporting to the IRS and withholding 30% on non-compliant FFIs.[1374]

9.3.1.2.1 Reportable Accounts

After the information on U.S. owners is collected and the FFIs realize they have reportable accounts, how the information[1375] gets from the FFI to the IRS depends upon whether they are under a Model 1 or Model 2 agreement or the final regulations.

The first question is what information must be reported? It depends on whether the account holder is a specified U.S. person or a U.S. entity.[1376] For an individual account, the following needs to be reported:

a) Name, address and TIN of each Account holder;
b) Account number;
c) Account balance or value;
d) Payments made to the account during the calendar year; and
e) Other information required under the regulations.[1377]

[1373] David Gannaway, *Key Provisions of the Foreign Account Tax Compliance Act*, 39 Est. Plan. 35 (September 2012); *See also,* Joshua D. Odintz, Michelle R. Phillips, Rodney W. Read & Mireille R. Zuckerman, *FATCA and Nonfinancial Entities: Practical Questions with Practical Answers*, 119 J. Tax'n 252 (December 2013).
[1374] David Gannaway, *Key Provisions of the Foreign Account Tax Compliance Act*, 39 Est. Plan. 35 (September 2012); *See also,* Joshua D. Odintz, Michelle R. Phillips, Rodney W. Read & Mireille R. Zuckerman, *FATCA and Nonfinancial Entities: Practical Questions with Practical Answers*, 119 J. Tax'n 252 (December 2013); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA* (Palgrave MacMillan 2019).
[1375] 26 U.S.C. §1471(b).
[1376] 26 C.F.R. §1.1471-4(d)(3)(ii)-(iii).
[1377] 26 C.F.R. §1.1471-4(d)(3)(ii)-(iii).

The information required for U.S.-owned entities is the same except one requirement. The name of the entity is required to be reported.[1378]

FFIs, after they document and identify the reportable accounts, the information must be reported annually to the IRS on its account holders who are classified as U.S. persons and foreign entities with substantial U.S. ownership.[1379]

Once it is understood what information must be reported to the IRS, the next question is how does the FFI transfer the information to the IRS? A Model 1 FFI, under the Model 1 IGA, does not have to send their reportable information directly to the IRS, but instead sends it to their government (most likely the tax authority) who, in turn, hands the information over to the IRS.[1380]

Under a Model 2 IGA, the FFIs are required to report the information directly to the IRS and consent is needed from each account holder to do so.[1381] If the account holder refuses to give consent, then they are considered a recalcitrant owner. FFIs who have recalcitrant owners are then required to report the aggregate number of recalcitrant accounts and the value of those accounts but the FFI is not required to close the account.[1382] This latter benefit – not having to close recalcitrant accounts – hinges upon the FFI entering into the FFI Agreement, complying with the requirements under the Agreement and the FATCA Partner government fulfilling their end when requests for information come from the IRS within 6 months of the request.[1383] These accounts are then subject to group requests from the IRS to the FATCA Partner.[1384] The FATCA Partner, under the Model 2 IGA, will have six months to respond by providing the requested information and, if not, the FFI will be required to treat the account as a

[1378] 26 C.F.R. §1.1471-4(d)(3)(ii)-(iii).
[1379] David Gannaway, *Key Provisions of the Foreign Account Tax Compliance Act*, 39 Est. Plan. 34, 35 (September 2012).
[1380] Model 1 Intergovernmental Agreement.
[1381] Model 2 Intergovernmental Agreement.
[1382] Model 2 Intergovernmental Agreement, art. 2, para. 2, subsections 1 &2.
[1383] Model 2 Intergovernmental Agreement; *See also*¸ International Adviser, *FATCA Model 2 Agreement Explained (*Nov. 20, 2012), *found at* https://international-adviser.com/fatca-model-agreement-explained/
[1384] Model 2 Intergovernmental Agreement, art. 2, para. 2, subsections 1 &2.

recalcitrant account holder which includes withholding tax where required by the regs.[1385]

For those FFIs that fall under the regulations (FFI Agreement) and not an IGA, they are to report the information they gather directly to the IRS.[1386] If the nation's law prevents the reporting of the information, then the FFI needs to get a waiver from its U.S. account holders.[1387] If the account holder refuses, the FFI should identify them as a recalcitrant owner and the FFI is required to close the account.[1388] A valid waiver is a waiver that "*permits the participating FFI to report to the IRS all of the information*" required with respect to the U.S. account.[1389]

9.3.1.2.2 Individual Taxpayer Reporting

While it seems that 26 U.S.C. §1471 is the cornerstone of FATCA, there is actually a second aspect to it that also imposes a burden on individual taxpayers to report certain information.[1390] This second aspect addresses what Douglas J. Workman noted as a problem even back in 1982: voluntary compliance by U.S. taxpayers.[1391] Chapter 3 of this thesis reflects and supports the fact that voluntary compliance by taxpayers was both a problem and a concern held by the U.S. government in the 1980s. 26 U.S.C. §6038D, added to the tax code by the Hire Act and which expanded the categories of information on foreign assets that must be reported, requires that any U.S. taxpayer who has interest in a "*specified foreign financial asset"* to report information regarding the foreign account if the aggregate amount of the assets is over $50,000.[1392]

[1385] Model 2 Intergovernmental Agreement, art. 2, para. 2, subsections 1 &2 and art. 3, para. 2, subsection b.
[1386] 26 U.S.C. §1471; *See also*, 26 C.F.R. §1.1471-4 (a)(3)
[1387] 26 U.S.C. §1471(b)(F).
[1388] 26 U.S.C. §1471(b)(F); *See also*, 26 C.F.R. §1.1471-4(i)(1)-(2).
[1389] 26 U.S.C. §1471(b)(F); *See* also, 26 C.F.R. §1.1471-4(i)(1)-(2).
[1390] 26 U.S.C. §6038D
[1391] Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes*, 73 J. Crim. L. & Criminology 675, 704 (Summer 1982).
[1392] 26 U.S.C. §6038D(a).

A specified foreign financial asset is defined as any financial account held by an individual with any interest and managed by an FFI and specific assets[1393] that are not held by a financial institution but are issued by non-U.S. persons or interest in a foreign entity[1394]. For example, interest in a foreign entity, a contract held for investment or stock are considered "*specified foreign financial assets*."[1395]

The penalty for failure to disclose the assets is $10,000 unless it continues for more than ninety days and then the penalty becomes $10,000 for each 30-day period that the failure continues.[1396] The withholding penalty statute §1471 put the requirement on the foreign financial institution to report a U.S. taxpayer's foreign accounts and the penalty is against the FFI. However, with this additional statute, the responsibility is put on the taxpayer to report the foreign asset and if the taxpayer fails to comply, then the taxpayer is the one who pays the penalty.

John Paul argues that the burden of FATCA was placed on both the Americans living abroad and the foreign financial institutions but the Americans residing in the United States do not bear any part of that burden. However, in the next sentence he states that FATCA affects all U.S. citizens who hold a foreign account.[1397] As the Crawford Court discussed correctly, FATCA applies to all U.S. citizens both abroad and resident in the U.S. when they hold a foreign account.[1398] There is no discrimination when both the taxpayer at home and the taxpayer living abroad are held to the same standard. If they both have foreign accounts, they both are required to report them. If they fail to report then they are both subject to the same penalties.

[1393] 26 U.S.C. §6038D(b)(2)(A)-(B)
[1394] 26 U.S.C. §6038D(b)(2)(C)
[1395] 26 U.S.C. §6038D(b)(1)-(2)
[1396] 26 U.S.C. §6038D(d).
[1397] John Paul, *The Future of FATCA: Concerns and Issues*, 37 N. E. J. Legal Stud. 52, 53 (Spring/Fall 2018).
[1398] *Crawford v. U.S. Department of Treasury*, 2016 WL 1642968 (S.D. Ohio, 2016), aff'd in *Crawford v. U.S. Dep't of Treasury*, 838 F.3d 438 (6th Cir., 2017), certiorari denied, *Crawford v. Dep't of Treasury*, 138 S.Ct. 1441 (2018).

The hope of the IRS is that an international withholding regime will be created – via the FATCA reporting requirements and enforced by the 30% penalty – which will reflect the domestic system in the U.S.[1399]

9.3.1.3 Withholding – Enforcement Mechanism

Withholding is the third main objective and enforcement mechanism of FATCA.[1400] There is only one withholding rate under FATCA – 30% - which is the penalty that is the enforcement mechanism.[1401]

Penalizing and incentivizing recalcitrant owners[1402] and non-participating FFIs (NPFFIs[1403]) into producing the information and documentation needed to identify and report on U.S. persons is the main purpose behind the withholding section of FATCA.[1404] The IRS has reiterated it would rather have tax compliance than have to enforce the 30% withholding penalty.[1405] This supports the IRS' assertion that the main focus of FATCA is reporting.[1406] The accuracy, or better, truthfulness, of the statement is in question among academics considering the large amount of money to

[1399] Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 743 (2014).
[1400] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).
[1401] 26 C.F.R. §1471; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).
[1402] A recalcitrant owner is an account holder that has not provided the FFI with the information that it requested so that the FFI can determine the owner's Chapter 4 (FATCA) status – U.S. Person or not.
[1403] A non-participating FFI is usually a financial institution that has not signed an FFI agreement and is resident in a jurisdiction that has executed an IGA.
[1404] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).
[1405] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).
[1406] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).

be recouped through FATCA.[1407] The IRS probably wants a lot of both – money and compliance. However, the more FATCA incentivizes the compliance, the less of need for the enforcement mechanism.

A note here about whether this withholding is a penalty or a tax because there is a disagreement among scholars.[1408] Ross McGill argues, persuasively so, that the 30% withholding is a penalty and not a tax because despite being administered through the tax system, it is not an tax on income but a penalty for failure to comply with the documentation procedures required.[1409] This is the correct interpretation. The confusion between whether it is a tax, or a penalty might stem from the legislative history. Senator Levin, when describing what has become known as FATCA, he described the withholding in one sentence as a 30% withholding tax and in the next sentence described it as a "*steep penalty"*.[1410] Then he continues to call it a tax in the rest of his statement.[1411] Senator Levin's use of the word "penalty" though is supported by what he explains the FFI will have to do to avoid the 30% withholding.[1412] He states that an FFI will have to *"….obtain and verify information which will make it possible for them to determine which of their accounts belong to U.S. accountholders, report key information about those U.S. account holders and comply with any request by the Treasury Secretary related to those U.S. accounts."*[1413] A tax, as defined by Black's law, is a "*monetary charge imposed by the government on persons, entities, or*

[1407] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013).
[1408] Joanna Heiberg, *FATCA: Toward a Multilateral Automatic Information Reporting Regime*, 69 Wash. & Lee L. Rev. 1685, 1700 (2012); *See also*, William Byrnes & Robert J. Munro, *Background and Current Status of FATCA*, Legal Research Studies Paper Series, Research Paper No. 17-31, §1.03[1] (March 1st, 2017) *found at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926119; Crawford *v. U.S. Department of Treasury*, 2016 WL 1642968 (S.D. Ohio, 2916), *aff'd in Crawford v. U.S. Dep't of Treasury*, 838 F.3d 438 (6th Cir., 2017), *certiorari denied, Crawford v. Dep't of Treasury,* 138 S.Ct. 1441 (2018); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 150 (Palgrave MacMillan 2013); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 219 (Palgrave MacMillan 2019).
[1409] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 219 (Palgrave MacMillan 2019).
[1410] 156 Cong. Rec. S1745 (March 18, 2010).
[1411] 156 Cong. Rec. S1745 (March 18, 2010).
[1412] 156 Cong. Rec. S1745 (March 18, 2010).
[1413] 156 Cong. Rec. S1745 (March 18, 2010).

property to yield public revenue."[1414] A penalty, on the other hand, is defined as "*punishment imposed on a wrong-doer, especially in the form of imprisonment or fine*."[1415] The 30% is not the government charging a tax to raise public revenue but, instead, and based on Senator Levin's own explanation, it is to punish the FFIs for not complying with the requirement to obtain information on U.S. accounts and to provide that information to the Treasury (IRS).[1416]

The 30% withholding penalty is only applied to U.S.-sourced FDAP income that is paid to certain categories of account holders.[1417] Just as Chapter 3 (QI – Chapter 7) withholding affected FDAP income payments, Chapter 4 (FATCA) withholding affects FDAP and gross proceeds[1418] income.[1419] FATCA affects a broader swath of income under Chapter 4 withholding in order to make the "stick" have a bigger impact when it lands.[1420] In order to apply this withholding, an account holder must have received US-sourced FDAP income and either be recalcitrant or a NPFFI.[1421] The 30% withholding penalty can also be applied against a non-financial foreign entity (NFFE) where the NFFE is a beneficial owner and they do not provide certification that they have no substantial U.S. owners or, if they do have U.S. owners, do not provide the

[1414] Black's Law Dictionary, 7th edition (Bryan A. Garner, editor 1999).
[1415] Black's Law Dictionary, 7th edition (Bryan A. Garner, editor 1999).
[1416] 156 Cong. Rec. S1745 (March 18, 2010).
[1417] 26 U.S.C. §1471 (b)(1)(D); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).
[1418] As of 19 Feb. 2019, the Treasury was looking at complaints made by FFIs about the burden of withholding on gross proceeds and has proposed removing gross proceeds from the definition of withholdable payments under 26 C.F.R. §1.1473-1(a)(1) *found at* https://www.federalregister.gov/documents/2018/12/18/2018-27290/regulations-reducing-burden-under-fatca-and-chapter-3
[1419] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013).
[1420] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 165 (Palgrave MacMillan 2013).
[1421] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 164 (Palgrave MacMillan 2013); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 175 (Palgrave MacMillan 2019).

name, address and tax identification number of each substantial U.S. owner.[1422] This is how FATCA ensures that the IRS will receive information on U.S. taxpayers and their foreign accounts.

There are two situations in which FATCA withholding can occur. The first happens when an FFI directly withholds on a recalcitrant owner whose account is held by said FFI.[1423] The second occurs where the withholding on the payment happens further up the chain – possibly at the highest level which is at the U.S. Withholding Agent's level. [1424] This election, whether there is direct withholding or not, occurs when the FFI registers with the IRS.[1425] The second option, the pass-thru payment, occurs from the eagle's point of view: the payment is from an upstream entity who does not directly make the payment to the recalcitrant owner who passes the payment through to its customers minus the 30% penalty.[1426] This establishes the problem of how to determine what proportion of any payment originally upstream in the payment chain is allocable to a given downstream, recalcitrant owner.[1427] This situation has been on hold until the IRS determines[1428] how to correctly handle the issues and complaints.[1429]

[1422] 26 U.S.C. §1472 (a)-(b); *See also*, 26 U.S.C. 1471(b)(1); Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int'l & Comp. L. Rev. 729, 745 (2014); Joshua D. Odintz, Michelle R. Phillips, Rodney W. Read & Mireille R. Zuckerman, *FATCA and Nonfinancial Entities: Practical Questions With Practical Answers*, 119 J. Tax'n 252, 253 (December 2013).

[1423] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 166 (Palgrave MacMillan 2013).
[1424] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 166 (Palgrave MacMillan 2013).
[1425] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 166 (Palgrave MacMillan 2013).
[1426] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 166 (Palgrave MacMillan 2013).
[1427] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 167 (Palgrave MacMillan 2013).
[1428] The last update was dated 1 January 2019.
[1429] Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 167 (Palgrave MacMillan 2013).

Because of the uncertainty of this, no further discussion will be taken in this thesis regarding this specific topic (pass-thru payments).[1430]

There is a difference between the withholding responsibilities of the FFIs under the Model IGAs and the regulations. Under the IGAs, there is no requirement for the FFIs to withhold the 30% unless there is non-compliance.[1431] For Model 1 IGAs, this means that as long as they deliver the U.S. accountholder information to the IRS they do not need to withhold the 30%, however, if there is significant non-compliance, then the partner country is to apply its own domestic laws to address the non-compliance.[1432] If the issue is not resolved within 18 months then the IRS may treat the FFI as non-compliant and can then require withholding the 30% penalty.[1433] Under Model 2 IGAs, there is no requirement to withhold the 30% unless the partner country fails to respond to a request by the U.S. on non-consenting accounts within six months. If that occurs, the FFI is required to withhold on the non-consenting accounts.[1434] If the issue is not resolved within one year, however, then the IRS may treat the FFI as non-compliant also.[1435]

In contrast to the IGAs, under the final regulations withholding is required on NPFFIs and recalcitrant owners.[1436] The identification of the payee of a payment determines whether withholding is actually required under the regulations by associating it with valid documentation obtained in the above sections.[1437] If the account is held by more than one individual, then each account holder is an individual payee that the

[1430] *See* https://www.federalregister.gov/documents/2018/12/18/2018-27290/regulations-reducing-burden-under-fatca-and-chapter-3
[1431] Model 1 Intergovernmental Agreement; *See also*, Model 2 Intergovernmental Agreement
[1432] Model 1 Intergovernmental Agreement
[1433] Model 1 Intergovernmental Agreement
[1434] Model 2 Intergovernmental Agreement
[1435] Model 1 Intergovernmental Agreement
[1436] 26 U.S.C. §1471(a); *See also*, 26 C.F.R. §1.1471-4(a)(1).
[1437] 26 C.F.R. §1.1471-4(a)(1).

withholding determination needs to be made on.[1438] If the payment is made to an entity, then the payee is considered the account holder.[1439]

This part of FATCA leaves non-compliant FFIs at a great disadvantage when trying to compete within the U.S. financial markets. FFIs that want to comply but may be held back from complying because of local regulations (secrecy or privacy rules) can choose to either seek a waiver from the American account holder or, if this cannot be accomplished, close the account.[1440] This allows the FFI to avoid having the 30% penalty applied and to continue to participate in the U.S. financial markets.

FATCA implements this very harsh penalty in order to enforce compliance with the U.S. tax laws. Although it does not just enforce U.S. tax laws, it also attempts to circumvent foreign jurisdictions' privacy or secrecy laws in order to procure the information the IRS needs to administer the tax law. This club-style[1441] penalty has been highly criticized by multiple sources, including the FFIs, foreign governments and American citizens abroad.

The compound stipulations of 26 U.S.C. §6038D and 26 U.S.C. §1471, addressing both the FFIs that hold the accounts and the U.S. taxpayers themselves, form a nearly impenetrable wall of reporting requirements that forces the veil of bank secrecy in foreign jurisdictions to be lifted and for the U.S. government to reach into foreign accounts of U.S. citizens and procure information needed to administer the tax laws correctly and fairly.[1442]

[1438] 26 C.F.R. §1.1471-4(b)(2).
[1439] 26 C.F.R. §1.1471-4(b)(2).
[1440] Model 1 Intergovernmental Agreement; *See also*, Model 2 Intergovernmental Agreement
[1441] David Rosenbloom, Oluyemi Ojutiku & Isabel Munarriz, *The Foreign Account Tax Compliance Act and Notice 2010-60*, 3 Intern'l Tax 354-355 (December 2010).
[1442] David Gannaway, *Key Provisions of the Foreign Account Tax Compliance Act*, 39 Est. Plan. 35 (September 2012); *Crawford v. United States Dep't of Treasury*, No. 3:15-CV-00250 (S.D. Ohio, 2016).

9.4. INTERGOVERNMENTAL AGREEMENTS

9.4.1. INTRODUCTION

When FATCA was first enacted, there were multiple problems that presented themselves. First, FATCA does not create a legally enforceable reporting obligation on the FFIs since they are not subject to the jurisdiction of the U.S.[1443] Second, the legal requirements of FATCA put the FFIs in conflict with their jurisdiction's banking/privacy laws.[1444] They felt they were in the position of having to choose between complying with FATCA to avoid the 30% penalty (or being locked out of the U.S. financial markets) or violate their jurisdiction's laws. FATCA does not stand on its own as a result of the extra-territorial nature of the law. The U.S. government then needed to fix these issues so that they could use FATCA to procure U.S. taxpayer information on their foreign accounts. This fix came in the form of Intergovernmental Agreements (hereinafter referred to as IGAs).[1445] The IGAs help to implement the reporting requirements required by FATCA.[1446]

The U.S. has multiple agreements, including treaty provisions as seen in Chapter 8, in order to help facilitate the exchange of information on U.S. citizens who may possibly be noncompliant, with foreign jurisdictions.[1447] One type of agreement that the U.S. is a party to is a TIEA also discussed in Chapter 8. Even with these types of

[1443] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981 (2017).
[1444] Edward Tanenbaum, *Here They Come: FATCA Intergovernmental Agreements*, 41 Tax Mgmt. Int'l J. 623 (2012); *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 159 (Palgrave MacMillan 2019).
[1445] James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981 (2017); *See also*, Edward Tanenbaum, *Here They Come: FATCA Intergovernmental Agreements*, 41 Tax Mgmt. Int'l J. 623 (2012); Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service, 7-5700 (September 7, 2016); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 160 (Palgrave MacMillan 2019).
[1446] Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service, 7-5700 (September 7, 2016).
[1447] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 9 (March 2009.

agreements in place, the problem of accessing information still occurs due to the structure of those agreements. For example, the IRS was usually required, pre-FATCA, to know a significant amount of information regarding the noncompliance with the tax laws before the foreign jurisdiction would hand over the information using the TIEA and treaty avenue.[1448] A GAO report gives the example that the TIEA does not allow for an across-the-board inquiry into a large group of accounts or corporations, but instead, the request for information has to be very narrow and target specific in order to identify the taxpayer, it has to state reasonable grounds for the belief that the foreign jurisdiction holds the information needed and the tax purpose behind the request.[1449] The IRS has found that this procedure is both inefficient and that it impedes their examination of noncompliance issues. If the TIEA or treaty provisions are inefficient, the IRS must find other legal and investigative measures such as the other anti-tax evasion measures mentioned in the previous chapters. This is why FATCA was enacted and why the IGAs were created to help facilitate FATCA.[1450]

9.4.2. INTERGOVERNMENTAL AGREEMENTS

The U.S. Department of Treasury, in order to simplify FATCA, reduce the costs associated with it and to address the conflict that FATCA puts the FFIs at odds with the laws of the jurisdiction it is resident in, collaborated with other nations to develop proposals that would allow for alternative compliance with FATCA.[1451] The jurisdictions are categorized into three classes: jurisdictions that have executed IGAs

[1448] *GAO, Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 9 (March 2009.
[1449] *GAO, Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 9-10 (March 2009.
[1450] GAO, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, GAO-09-478T, 10 (March 2009.
[1451] Ehab Farah, FATCA: *Recent Developments and the Intergovernmental Model I Agreement*, 26 J. Tax. & Reg. Fin. Inst. 5, 7 (Jan/Feb 2013); See also, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 396 (IBFD, August 2014); Marnin Michaels, *International Taxation: Withholding*, ¶6.07 (September 2018).

with the United States, those that have not yet executed agreements and jurisdictions that have agreed in principle to execute an agreement but have not done so yet.[1452] The latter group's agreement is considered an "*in substance*" agreement.[1453] These model agreements are an alternative approach – not an exception – to the final FATCA regulations and are meant to simplify the procedure for identifying U.S. accounts and complying with the collecting and reporting information that are found within the FATCA statues and regulations.[1454] In February 2012, the United States signed Joint Statements with France, Germany, Italy, the UK, Spain, Japan and Switzerland in order to assist in the implementation of FATCA.[1455] The main purpose of the Joint Statement between the first five countries was to express the shared motive to build bilateral exchanges of information that is the base for the intergovernmental

[1452] Department of the Treasury, *Foreign Account Tax Compliance Act, found at* https://home.treasury.gov/about/offices/tax-policy/foreign-account-tax-compliance-act; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 160 (Palgrave MacMillan 2019).

[1453] Department of the Treasury, *Foreign Account Tax Compliance Act, found at* https://home.treasury.gov/about/offices/tax-policy/foreign-account-tax-compliance-act; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 160 (Palgrave MacMillan 2019).

[1454] Edward Tanenbaum, *The FATCA Model 2 Intergovermental Agreement* (January 11, 2013) *available at (*https://www.bna.com/fatca-model-intergovernmental-n17179871809/; *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

[1455] U.S. Department of Treasury, Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA (Feb. 8, 2012), found at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf; See also, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable*? Bulletin for International Taxation, 395, 397 (IBFD, August 2014); D.S. Kerzner and D.W. Chodikoff, *International Tax Evasion in the Global Information Age*, 317 (Palgrave MacMillan 2016); Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).

framework.[1456] This approach would accomplish a number of goals: 1) to have the relevant foreign government enact legislation that would require the FFIs in those jurisdictions to collect and report information to its tax authorities, 2) to allow those FFIs to apply necessary due diligence procedures to identify U.S. accounts and 3) to transmit the information to the IRS through the automatic exchange of information procedures.[1457] The IGAs would eliminate the need for the FFI agreement between the IRS and FFIs because certain categories of FFIs would be "*deemed compliant*" through the Intergovernmental Agreement executed between the U.S. and the FATCA Partner.[1458] This approach, which led to the Model 1 IGA (discussed in subsection 9.4.2.1), was seen as a modification to FATCA's unilateral approach but it was also viewed as necessary to address the apparent conflict between FATCA partners' local laws and the requirements of FATCA.[1459]

The joint statement between Japan and Switzerland, both Model 2 agreement countries (discussed in subsection 9.4.2.2), had the purpose of expressing "*bilateral intentions for the intergovernmental cooperation in order to overcome the legal difficulties which arose from the incompatibility of FATCA with certain provisions of*

[1456] U.S. Department of Treasury, Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA (Feb. 8, 2012), found at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf; See also, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable*? Bulletin for International Taxation, 395, 397 (IBFD, August 2014); Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).
[1457] Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).
[1458] Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).
[1459] Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).

national legislation"[1460], for example, secrecy laws in Switzerland. As of April 2020, more than one hundred IGAs are in effect, either identified as in force, signed or as an agreement in substance.[1461]

Model 1 and Model 2 are utilized by the Department of the Treasury in order to facilitate the exchange of information.[1462] The IGAs provide benefits for the financial institutions whose jurisdiction enters into an IGA with the U.S.[1463] Each model also has a sub-model for agreements with countries that do not have tax treaties or TIEAs with the U.S.[1464] While FATCA's statutes and regulations detail the procedure originally enacted, the IGAs detail the alternative process that allows the FFIs to cooperate with FATCA once the foreign jurisdiction enacts FATCA into the domestic

[1460] U.S. Department of Treasury, Joint Statement From the United States and Switzerland Regarding a Framework for Cooperation to Facilitate the Implementation of FATCA (June 21, 2012), found at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Switzerland-06-21-2012.pdf; See also, U.S. Department of Treasury, Joint Statement from the United States and Japan Regarding a Framework for Intergovernmental Cooperation to Facilitate the Implementation of FATCA and Improve International Compliance (June 21, 2012), found at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Japan-06-21-2012.pdf; See also, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable*? Bulletin for International Taxation, 395, 397 (IBFD, August 2014).

[1461] IRS, *Foreign Account Tax Compliance Act Resource Center*, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx; *See also*, Marnin J. Michaels, *International Taxation: Withholding*, ¶ 6.07 (Thomson Reuters Tax and Accounting, September 2018).

[1462] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 397 (IBFD, August 2014); Marnin Michaels, *International Taxation: Withholding*, ¶6.07 (September 2018); Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 121 (Palgrave MacMillan 2013); Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).

[1463] U.S. Department of Treasury, *Models 1 and 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Ross K. McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 160 (Palgrave MacMillan 2019).

[1464] IRS, Foreign Account Tax Compliance Act Resource Center, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx; ; *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 396 (IBFD, August 2014); Marnin Michaels, *International Taxation: Withholding*, ¶6.07 (September 2018).

legislation.[1465] The regulations and code support the application and interpretation of the IGAs.[1466] When there is an existing treaty or TIEA between the U.S. and the FATCA partner, the IGA utilizes the existing treaty or TIEA structure and practices and procedures as the authority for the IGA requirements.[1467] When there is no pre-existing treaty or TIEA, then the parties draft their own practices and procedures within the agreement based on FATCA's statues and regulations.[1468]

9.4.2.1 Model 1 Agreement

The first type of IGA model agreement, Model 1, has two forms: a reciprocal (1a) and non-reciprocal (1b) form.[1469] Model 1a is the only agreement that allows for the reciprocal exchange of information between the U.S. and its FATCA partners and is the most used – most likely due to the reciprocity provision.[1470] This autonomous

[1465] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 397 (IBFD, August 2014); *See also*, James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Policy*, 34 Wis. Int'l L. J. 981 (2017).
[1466] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 397 (IBFD, August 2014).
[1467] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).
[1468] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).
[1469] Intergovernmental Agreement Model 1, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx;; *See also,* IRS, Foreign Account Tax Compliance Act Resource Center, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx; Ehab Farah, *FATCA: Recent Developments and the Intergovernmental Model I Agreement*, 26 J. Tax. & Reg. Fin. Inst. 5, 8 (Jan/Feb 2013).
[1470] Intergovernmental Agreement Model 1, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx; *See also*, U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments,* Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 397 (IBFD, August 2014).

agreement[1471], which builds its own scope regarding how to identify reportable information but still reflects the FATCA regulations, requires the U.S. to reciprocate and provide information to the partner country on financial accounts that the partner country's citizens hold in the U.S.[1472] This Model 1a agreement is made with countries that the U.S. Treasury Department has confirmed have strong privacy protections in place to ensure the confidentiality of the information exchanged.[1473] The Model 1a created a two-step reporting system.[1474] The first step requires, after the FFIs have taken the steps of identifying and documenting U.S. accounts, that the FFI reports the collected information to their governments which is usually the taxing authority.[1475] The partner country's taxing authority takes the responsibility of reporting the

[1471] Intergovernmental Agreement Model 1, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx; *See also*, U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 398 (IBFD, August 2014).

[1472] U.S. Department of Treasury, *Model 1 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Ehab Farah, F*ATCA: Recent Developments and the Intergovernmental Model I Agreement*, 26 J. Tax. & Reg. Fin. Inst. 5, 8 (Jan/Feb 2013); See also, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

[1473] U.S. Department of Treasury, *Model 1 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Ehab Farah, *FATCA: Recent Developments and the Intergovernmental Model I Agreement*, 26 J. Tax. & Reg. Fin. Inst. 5, 8 (Jan/Feb 2013).

[1474] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx;; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1475] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx;; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

information directly to the IRS and off of the FFIs.[1476] This second step is for the FATCA partner government to directly relay the information to the IRS.[1477] The information must be exchanged annually on an automatic basis and there is no requirement for the FFI to enter into an FFI agreement with the IRS.[1478] The FFI only has to comply with the IGA's reporting requirements and register on the FATCA registry on the IRS website.[1479] This is one of the benefits that FFIs receive under an IGA. Under Model 1, the FFI does not have to withhold on payments to or close the accounts of recalcitrant account holders (another benefit) as long as the FATCA partner sends the information to the IRS.[1480] If there is significant non-compliance by the FFI with the IGA, then the FATCA partner has to apply its own domestic laws to

[1476] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx;; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1477] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1478] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).

[1479] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1480] U.S. Department of Treasury, *FATCA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 4 (September 7, 2016); *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

address the non-compliance and it has 18 months to resolve it.[1481] If it is not resolved in the stated timeframe, the FFI may be treated as FATCA non-compliant.[1482]

Maryte Somare and Viktoria Woehrer argue that Model 1a is not a truly reciprocal agreement because the FATCA partner is under heavier reporting obligations than the United States is.[1483] The first reason is that the FFIs in FATCA partner countries have a more comprehensive procedure to go through in order to identify the U.S. accounts in their institution, however, the U.S. financial institutions do not have to endure the same extensive procedure.[1484] The second reason that supports their assertion is that FFIs in FATCA partner jurisdictions are required to identify U.S. controlling owners of foreign entities.[1485] There is no parallel requirement of U.S. financial institutions that requires them to report controlling foreign owners of U.S. entities.[1486] The third, and final, reason that FATCA partners are under heavier reporting obligations is that the financial information that is to be exchanged is far more extensive for the FATCA partner than it is for the U.S.[1487] When examining the Model 1a IGA, the analysis supports the argument that Model 1a is not truly reciprocal. While the FATCA partner does receive some information from the U.S., it is not equal in nature to the what the

[1481] U.S. Department of Treasury, *Model 1 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).
[1482] U.S. Department of Treasury, *Model 1 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).
[1483] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 398 (IBFD, August 2014).
[1484] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 39 (IBFD, August 2014).
[1485] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 398 (IBFD, August 2014).
[1486] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 398 (IBFD, August 2014).
[1487] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 398 (IBFD, August 2014).

FATCA partner is required to deliver to the IRS. When comparing the U.S. exchange requirements to the information exchange that the FATCA partner is required to deliver, the requirements are not proportionate. If the information exchange was truly reciprocal, then each partner to the agreement would receive the same level of information. The United States undeniably benefits more from this Model form than do the FATCA partners.

Model 1b is the second form used and is the non-reciprocal version which means that no information is given to the partner country.[1488] This version of the Model 1 IGA can be entered into whether or not there is an existence of a TIEA or tax treaty between the United States and its FATCA partner.[1489] There are roughly thirty jurisdictions that have signed Model 1b IGAs with the United States and among those jurisdictions are countries like Algeria, Cayman Islands and the UAE.[1490]

The key difference between Model 1b and Model 1a can be found in the Article 2 of both agreements.[1491] Article 2 in both Models lays out the information in paragraph 2 that the FATCA partner has to exchange.[1492] Model 1a has a second subsection to paragraph 2 that lays out the information the U.S. has to give to the FATCA partner – Model 1b, para. 2 does not have this subsection.[1493]

[1488] Intergovernmental Agreement Model 1b, art. 2 *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also,* Ehab Farah, *FATCA: Recent Developments and the Intergovernmental Model I Agreement*, 26 J. Tax. & Reg. Fin. Inst. 5, 8 (Jan/Feb 2013).
[1489] Intergovernmental Agreement Model 1b, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 989 (2016-2017).
[1490] Intergovernmental Agreement Model 1b, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx
[1491] Intergovernmental Agreement Model 1a and Model 1b, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx;.
[1492] Intergovernmental Agreement Model 1a and Model 1b, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx
[1493] Intergovernmental Agreement Model 1a and Model 1b, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx

9.4.2.2 Model 2 Agreement

Parallel agreements with both Switzerland and Japan led to the creation of Model 2 which is more limited in scope than is Model 1 and is based almost entirely on the FATCA statutes and regulations.[1494] This version of the Model agreement has been chosen by countries that have strong privacy and banking secrecy laws such as Bermuda and Switzerland, both of whom have Model 2 agreements with the U.S.[1495] The list of countries that have executed a Model 2 agreement is relatively short.[1496]

The purpose of the Model 2 agreement is to give the FFIs in Model 2 jurisdictions the legal framework for the FFIs to directly relay the information on U.S. account holders to the IRS.[1497] Model 2 agreements are wholly different than Model 1 in that this agreement is between the IRS and the FFI and not the government of the jurisdiction

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[1494] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Jane G. Song, *The End of Secret Swiss Accounts?: The Impact of the U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts*, 35 Nw. J. Int'l L. & Bus. 687, 703 (2015); Edward Tannenbaum, https://www.bna.com/fatca-model-intergovernmental-n17179871809/; Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 396 (IBFD, August 2014).

[1495] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 397 (IBFD, August 2014).

[1496] Model 2 countries as of June 2019: Armenia, Austria, Bermuda, Chile, Hong Kong, Iraq, Japan, Macao, Moldova, Nicaragua, Paraguay, San Marino, Switzerland and Taiwan, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, James F. Kelly, *International Tax Regulation By United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 Wis. Int'l L. J. 981, 985 (2016-2017).

[1497] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 396 (IBFD, August 2014).

the FFI is found in.[1498] Instead of reporting to the competent authority as in Model 1, FFIs instead sign a Foreign Financial Institution Agreement with the IRS, register on the IRS' website[1499] and deal directly with the IRS.[1500] The FFI collects and reports the information - based on the requirements of the FFI agreement and Treasury regulations - on U.S. accounts after requesting consent from each U.S. account holder which allows the FFI to report the information to the IRS.[1501] If the U.S. account holder refuses to give consent, the FFIs then report the aggregate information on the account.[1502] This is a benefit to the Model 2 agreement. Instead of having to claim that those account holders who refuse are recalcitrant and potentially shutting down the accounts as the regulations require, they are allowed to report aggregate information on the accounts. Based on the information that the United States receives from the FFIs in the foreign jurisdiction regarding non-consenting accounts, the US then makes a request for an exchange of information from that government who then has six

[1498] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Edward Tanenbaum, *The FATCA Model 2 Intergovernmental Agreement* (January 11, 2013) *available at (*https://www.bna.com/fatca-model-intergovernmental-n17179871809/

[1499]U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, IRS Rev. Proc. 2017-16; Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).

[1500] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1501] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399-400 (IBFD, August 2014).

[1502] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

months to provide the information sought.[1503] The only role the foreign government plays under Model 2 is to enable the FFIs to comply with FATCA and to respond to requests by the U.S. when the U.S. makes a request for an exchange of information.[1504] If the FFI is noncompliant, then the FFI has twelve months to resolve the noncompliance or the FFI will be treated as FATCA noncompliant.[1505]

The FFI agreement that is used with Model 2 does not detail the information that is to be collected and reported and, instead, references the FATCA regulations.[1506] Section 6 of the Revenue Procedure 2017-16 provides the text of the 54-page FFI agreement.[1507]

One key distinction between Model 1 and Model 2 is that Model 1 is the form where the foreign government is involved and agrees to be the transmitter of the information on U.S. account holders collected by the FFIs.[1508] In this scenario, consent does not have to be given for the information to be delivered from the government to the IRS.[1509] This reflects the automatic exchange of information that the U.S. government

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[1503] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016); Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1504] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 399 (IBFD, August 2014).

[1505] U.S. Department of Treasury, *Model 2 IGA, found at* https://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca.aspx; *See also*, Congressional Research Service, Erika K. Lunder and Carol A. Pettit, *FATCA Reporting on U.S. Accounts: Recent Legal Developments*, Congressional Research Service Report, 3 (September 7, 2016).

[1506] Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

[1507] IRS Rev. Proc. 2017-16 *found at* https://www.irs.gov/pub/irs-drop/rp-17-16.pdf

[1508] *Crawford v. U.S. Department of Treasury*, 2016 WL 1642968 (S.D. Ohio, 2916), aff'd in *Crawford v. U.S. Dep't of Treasury*, 838 F.3d 438 (6th Cir., 2017), certiorari denied, *Crawford v. Dep't of Treasury*, 138 S.Ct. 1441 (2018); See also, Intergovernmental Agreement Model 1a and Model 2, found at https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx.

[1509] Edward Tanenbaum, *The FATCA Model 2 Intergovernmental Agreement* (January 11, 2013), *available at* https://www.bna.com/fatca-model-intergovernmental-n17179871809

has wanted to achieve with art. 26 in the Income Tax Treaties and the TIEAs (Chapter 8). Model 2 governments, on the other hand, agree to modify their laws in order to allow their FFIs to report their information directly to the IRS. Under Model 2 agreements, consent is from the account holders is required since the FFI deals directly with the FFI.[1510] Another distinction is how both Models treat recalcitrant owners.[1511] The definition of recalcitrant owner is defined as any account holder that fails to comply with reasonable requests for the information or fails to provide a waiver upon request.[1512] Model 1a does not require the FFI to withhold payments or close accounts on recalcitrant owners if they have specific information – name, address and tax identification number - on U.S. account holders and controlling U.S. persons of foreign entities.[1513] In contrast, Model 2 is not required to withhold taxes or close accounts as long the FFI reports the aggregate number and value of all accounts held by recalcitrant owners.[1514]

[1510] Intergovernmental Agreement Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx,; *See also*, Edward Tanenbaum, *The FATCA Model 2 Intergovernmental Agreement* (January 11, 2013), *available at* https://www.bna.com/fatca-model-intergovernmental-n17179871809

[1511] Intergovernmental Agreement Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

[1512] 26 U.S.C. §1471 (d)(6).

[1513] Intergovernmental Agreement Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

[1514] Intergovernmental Agreement Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).

In both Models, however, Annex I deals with the due diligence procedures and obligations and Annex II deals with exempt beneficial owners and compliant FFIs.[1515] Both Models also allow for the use of Treasury Regulations instead of the IGA provisions.[1516]

9.5. CONCLUSION

The anti-tax evasion withholding framework known as FATCA is a complicated, technical piece of legislation that created a foreign third-party reporting system that would hopefully incentivize FFIs into reporting on U.S. taxpayer foreign accounts. The key to FATCA is the identification and documentation of U.S. accounts so that the FFI can report the required information back to the U.S. government. For those FFIs that are non-compliant or for recalcitrant account holders, a 30% penalty is to be applied to certain types of payments made to those accounts.

The question facing this chapter is whether FATCA, as implemented, allows the U.S. government to procure information on U.S. taxpayers' foreign accounts? The answer to that question is complicated and multi-faceted and depends upon the parameters used to evaluate FATCA. First, if the evaluation is based on how FATCA has performed since it came into effect, the answer is it is hard to evaluate because information on data of repatriated revenue is nonexistent.[1517] There is also no information on how many accounts they have received information on that the author

[1515] Intergovernmental Agreement Annexes for Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).
[1516] Intergovernmental Agreement Models 1 and 2, *found at* https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx, *See also*, Maryte Somare and Viktoria Woehrer, *Two Different FATCA Model Intergovernmental Agreements: Which is Preferable?* Bulletin for International Taxation, 395, 400 (IBFD, August 2014).
[1517] Ross McGill, *U.S. Withholding Tax: Practical Implications of QI and FATCA*, 259-260 (Palgrave Macmillan 2019).

has been able to locate on either the IRS or the Department of the Treasury website. A reason for this could be that while the other measures examined in the thesis have been around for decades FATCA has been in effect for less than a decade.

If the evaluation of the effectiveness of FATCA is based on how it is implemented on paper, then the answer is no and yes. The answer is no, FATCA, as enacted, does not allow for the U.S. government to procure the information on U.S. taxpayers' foreign accounts because many FFIs could not provide that information to the U.S. government based on the secrecy and privacy rules that exist in many foreign jurisdictions. To address those issues, the Department of the Treasury and the IRS created the Intergovernmental Agreements to assist in implementing FATCA. Through the IGAs, governments have agreed to work with the U.S. through either Model 1 (reciprocal information), Model 2 or through the regulations. For those governments that have not agreed, the U.S. has left an option open for the financial institutions of those countries to choose to comply with the U.S. if they decide to do so (regulations).

If the evaluation of the effectiveness of FATCA is based on how it is implemented on paper, the answer is yes, with the IGAs, it is an effective way – at least more effective than the other measures – to procure information on U.S. taxpayers' foreign accounts. The 30% penalty is a bull-in-the-china shop approach, but it is an effective incentive as 113 countries (out of 195) have executed IGAs with the U.S. government. This number does not account for the FFIs in non-IGA jurisdictions that have signed FFI agreements with the IRS.

One big problem that presents itself that is almost identical to that of the QI is that FATCA is extremely complicated and is written in highly technical legal language that if one is not a native English speaker, it would be extremely difficult to understand the obligations and responsibilities that one has. The suggestions here would be the same as the suggestions in the QI Chapter: utilize social media and technology in the form of video courses, explanatory (plain English) videos, podcasts and possibly, even diagrams to show how the system works. Addressing the cultural and linguistic issues

that exist could help non-U.S. persons, entities and FFIs to better understand the law which could increase compliance rates.

Another major issue that is not as easy to solve is the oversight and control over FFIs that are not in jurisdictions where there are IGAs in place. Similar to the IRS believing that NQIs in chapter 7 are instigators of tax evasion because they are believed to be assisting in tax evasion when they refuse to share their customers' information with the IRS, it is not a stretch to believe that those FFIs that are in jurisdictions that have no IGA and do not execute an FFI agreement under the regulations are could possibly be facilitating tax evasion. However, the lack of understanding based on the highly technical legal language could account for why some FFIs do not want to participate. There is still the problem of oversight and control of those FFIs that have U.S. accounts but do not agree to the FFI agreement. Because FATCA is so "young", it is hard to know if the 30% penalty and the inability to participate in the U.S. financial markets will eventually have an effect on those FFIs or whether they will simply continue to opt out and either take the hit of 30% or choose not to maintain U.S. accounts. This is another place, however, the U.S. might consider using a well-reasoned tax haven definition or blacklist (see Chapter 3, subsection 3.4) as suggested in the Qualified Intermediary Chapter (7). The IRS – in creating the QI program – noted that the jurisdictions that refused to cooperate with the program and were considered tax haven jurisdictions (or bank secrecy jurisdictions) needed more stringent oversight over the FFIs or their branches located in those jurisdictions.[1518] This could be applied to FATCA as well. For this scenario, a tax haven definition or a blacklist could help in identifying those jurisdictions where the FFIs need more oversight and which also might provide some incentive for the FFIs to fully cooperate with the program if they know they will be under more scrutiny because of the secrecy their jurisdiction provides to

[1518] IRS Rev. Proc. 2017-15; *See also,* IRS Announcement 2000-48, 2000-1 C.B. 1243; Marc D. Shepsman, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L. J. 1767, 1788 (2013); Stephen Troiano, *The U.S. Assault on Swiss Bank Secrecy and the Impact on Tax Havens,* 17 New Eng. J. Int'l & Comp. L. 317, 333 (2011).

those looking for it. It would also be a warning for taxpayers who are looking to open accounts in those jurisdictions that the IRS will be looking very closely at financial institutions in those jurisdictions. The IRS should consider raising penalties on U.S. taxpayers that have accounts in those jurisdictions and do not declare them, if they are discovered through measures other than voluntary disclosure.

The United States Congress should also increase the funding to the IRS. They enacted this extremely complicated law targeted at foreign financial institutions, most of whom do not have English as a first language. Then, over the last ten years, they have allowed the IRS' budget to decline[1519] which has resulted in the IRS being understaffed and has led to eroded enforcement. If Congress wants FATCA, the QI and the other measures to succeed in procuring taxpayer information on foreign accounts and to help in preventing tax evasion, Congress should fund the IRS so that enforcement of the laws they have enacted can occur.

[1519] Tax Policy Center, *Budge Blues*https://www.taxpolicycenter.org/taxvox/budget-blues-tax-administration

CHAPTER 10. FINAL CONCLUSIONS

10.1. CONCLUSIONS

The dissertation poses four questions. The first question asked what measures the U.S. government has taken to procure information on U.S. taxpayers' foreign financial accounts despite bank secrecy laws that prohibit the IRS from administering the tax laws correctly and fairly? The second question posited is how the anti-tax evasion measures are implemented in order to address the inability to procure information on U.S. taxpayers' foreign accounts? The third question examines whether the measures, when implemented, enable the IRS to procure formerly inaccessible taxpayer information on foreign accounts so that the IRS has all the facts to administer the U.S. tax laws correctly and fairly? If the answer to the third question is no, then a fourth question is proffered. If the measures do not permit the U.S. government to procure the information needed on U.S. taxpayers' foreign financial accounts, then what needs to be done to improve the measures, so it increases the IRS' chances of obtaining information on U.S taxpayers' foreign financial accounts?

To answer those questions, the thesis examines six anti-evasion measures that the U.S. government enacted because the U.S. government has had difficulty in procuring information on U.S. taxpayers' foreign financial accounts. Two methodologies are used in answering the questions. The first, legal dogmatics, uses the law itself to answer what measures are used by the U.S. government to try to procure the information needed and how the law (measures) itself is implemented in order to fulfill that purpose. The second method, the socio-legal method, focuses on whether the anti-tax evasion measures work and how to improve the measures if they do not work so that the IRS has increased chances of procuring information on U.S. taxpayers' foreign accounts.

The first two measures examined were the Report of Foreign Bank and Financial Accounts (FBAR – Chapter 4) and the Voluntary Disclosure programs (Chapter 5)

both of which depend on taxpayers' voluntarily disclosing their foreign financial accounts. The research demonstrated that while these programs were able to obtain some information on taxpayers' foreign accounts, the numbers of taxpayers involved compared to the numbers of U.S. taxpayers who hold foreign accounts was small. The U.S. government is still missing millions of taxpayers and their information and billions in lost revenue. The effectiveness of these two measures is lost when the penalties are not high enough that those that are intentionally evading their tax obligations do not feel the risk is high enough. The increase in both monetary penalties and jail time should increase the risk enough that those that intentionally evade choose to comply instead of evading. A reasonable cause exception should be made for those taxpayers that were unaware or made an innocent mistake to avoid applying harsh penalties and create untenable situations.

The next measure (Chapter 6) explored whether the U.S. government could obtain the information on U.S. taxpayers' foreign accounts by obtaining the information from third parties via the use of the John Doe summons, a legal process that occurs through the judicial branch of the U.S. government. This measure is limited by the discovery of groups of unknown taxpayers when investigating other cases or when taxpayers voluntarily comply and disclose information that leads the IRS to believe there are other U.S. taxpayers taking advantage of the same types of schemes as the ones disclosed through the voluntary disclosure program. Without the other measures, the John Doe summons is severely limited as a way to procure information on U.S. taxpayers' foreign accounts.

The chapter on art. 26 of the U.S. Model Income Tax Treaty and tax information exchange agreements scrutinized whether this type of measure (exchange of information) can procure the information on U.S. taxpayers' foreign accounts that the IRS needs through agreements with foreign governments. The examination of art. 26 in the income tax treaty found that it can be effective in obtaining information but how effective depends on a few conditions: 1) the ability of the U.S. to negotiate broad language that encompasses the U.S.' definition of tax evasion, 2) the cultural

differences between the U.S. and its treaty partner and 3) the willingness of the U.S. to trade information at the same level they expect from their treaty partners.

Chapters 7 and 9 explored whether the information the IRS needs on U.S. taxpayers' foreign accounts can be obtained through the Qualified Intermediary Program (QI) and the Foreign Account Tax Compliance Act (FATCA) both of which focus on foreign financial institutions as the source of that information. The QI program and FATCA are both tax withholding regimes. The QI program uses FFIs to document, withhold, deposit tax and report on certain types of income payments made to non-U.S. persons. FATCA, on the other hand, is a withholding regime that uses FFIs to identify and document U.S. persons who have accounts with the FFI and to report on those accounts or subject themselves to a 30% penalty. Both the QI and FATCA are severely limited by their highly technical language and the fact that a majority of the FFIs are not native English speakers. In both withholding regimes control and oversight over those FFIs that are not participating is problematic and does not allow for information on U.S. taxpayers' accounts held in those institutions to be verified.

Many of these measures would be more effective if several things occur. First, if Congress increased the IRS' funding more agents could be hired which in turn means that enforcement will be more consistent and effective. Without funding and a large number of agents, the IRS simply cannot track down tax evaders. Second, having an educational campaign for U.S. taxpayers – especially those living outside the U.S. – allows them to understand their tax obligations and should increase compliance among those not intentionally evading. Third, using an educational campaign for foreign financial institutions that is in plain English could increase compliance with the QI program and FATCA because as a non-native English speaker it is probably incredibly difficult to comprehend the highly technical language of both the QI and FATCA.

The evidence from the research on each measure suggests that the anti-tax evasion measures, taken independently, are not wholly effective in procuring information on U.S. taxpayers' foreign accounts. FATCA is the most effective because it forces the

FFIs to come to the table and share the information the U.S. is seeking. If they do not, then they are subject to a 30% penalty and are then locked out of the U.S. financial markets. However, even FATCA was not wholly effective because many of the FFIs could not meet FATCA's obligations without breaking their own jurisdiction's secrecy laws and, thus, the U.S. government had to draft the Intergovernmental Agreements to effectuate FATCA. FATCA, considered a major win, is also limited by the fact that many FFIs who do not want to hassle with the law either do not agree to become FFIs or they just refuse to maintain U.S. accounts (or conceal those accounts) which means the U.S. is not receiving information on those U.S. accounts.

The research ultimately supports the view that Richard A. Gordon expressed in his 1981 report on U.S. taxpayers who were using tax haven jurisdictions to evade taxes. He asserted, and this thesis supports the assertion, that there should be a coordinated federal attack. However, while Gordon argued for a coordinated attack on tax havens, it is actually secrecy that should be the target of the coordinated federal attack. The measures examined within these pages fulfill that coordinated attack because they work in concert together to assault the problem from different fronts. The first front focuses on who the U.S. government will obtain their information from. The measures examined in this dissertation obtain their information from the taxpayer themselves, third parties, foreign governments and foreign financial institutions (FFIs). The second front of the coordinated attack reaches across multiple federal agencies and their sub-agencies and all three branches of government to provide enforcement of those measures to ensure the information is procured. For example, the Judicial branch is involved in court cases that develop from these measures but also in approving the issuance of John Doe summons. The Executive branch is involved in negotiating tax treaties with foreign governments that try to procure information on taxpayer information on foreign accounts through exchange of information provisions while the Legislative branch ratifies those treaties. The Department of the Treasury and its sub-agency, the IRS, are the main agencies involved but other agencies such as the Department of Justice who prosecutes certain types of cases and conducts investigations on tax evasion are also involved. Congress does not just ratify treaties,

but they also hold hearings on issues relevant to this dissertation – for example, secrecy – and then draft and enact anti-tax evasion legislation. This weaving together of the different measures to attack secrecy from the different fronts should continue to be the approach of the U.S. government because secrecy and the ways to use it to obscure taxpayers' foreign accounts is constantly evolving and changing.

This dissertation contributes to the academic work by discussing in-depth the measures that make up the U.S. government's anti-tax evasion framework (federal coordinated attack) which is in place to allow the U.S. government to procure information on U.S. taxpayers' foreign accounts. Most literature that discusses the measures examined in this thesis do one of two things: 1) it either addresses most of the measures briefly while focusing mainly on the Foreign Account Tax Compliance Act (FATCA) or 2) it addresses one or two of the measures individually. This dissertation, on the other hand, explores all of the measures comprehensively while focusing on how they enable the U.S. government to procure information on U.S. taxpayers' foreign accounts. This dissertation also supports Richard A. Gordon's position that the U.S. needs a coordinated federal attack – found in the anti-tax evasion framework – only differing in the opinion that the attack should be on secrecy and not on tax havens.

The findings of the dissertation could be of interest to multiple persons or groups of people. First, the findings could be of interest to those in the international tax community who might be interested in how the U.S. handles secrecy and procuring information on their taxpayers' foreign accounts including those that represent U.S. taxpayers. This could include the tax authorities of foreign governments who may be trying to decide how to tackle secrecy and procure information on their own taxpayers' foreign accounts. This dissertation could also be of interest to those members in the U.S. Congress who are interested in drafting legislation that addresses secrecy and the continuing issue of trying to procure information on U.S. taxpayers' foreign accounts so that the tax laws are administered correctly and fairly. A broad overview of how these measure work together to procure information could help Congress change existing legislation or enact new legislation that continues the

coordinated federal attack while addressing the changes that happen in secrecy jurisdictions.

As a result of the research done within in this thesis further research could be considered in a couple of areas. First, further research could be done on FATCA and its effect on secrecy and its ability to procure taxpayer information. FATCA is the most forceful of the anti-tax evasion measures and the "older" FATCA gets the more data the U.S. government will have on its effectiveness. That data should be released so that academics and others can evaluate the effectiveness of FATCA. Additionally, exploring the effect of an educational campaign on U.S. taxpayers has on the compliance numbers and whether they would increase or decrease could be of interest to the U.S. government who should pursue the educational campaigns suggested in this dissertation. Another area that could be researched is how a tax haven definition or blacklist (See Chapter 3, subsection 3.4) could be effective within the QI Program and FATCA. A tax haven definition or blacklist could potentially be effective where FFIs who are in jurisdictions that either have stringent secrecy or refuse to cooperate with either the QI program or FATCA need more oversight. It would also be of academic interest to explore how the anti-tax evasion framework is effective (or not effective) on cryptocurrency, the new secrecy "jurisdiction", and if it is not effective, then how the different measures could be amended so as to be effective.

Bank and financial secrecy will never fully disappear. There will always be a jurisdiction somewhere that offers secrecy as a way for taxpayers to conceal their accounts and some taxpayers will always be looking for ways to conceal their accounts from the U.S. government. In order for the U.S. to procure information on U.S. taxpayers who hold accounts in those jurisdictions, the U.S. should continue to evaluate the changing secrecy landscape and continue to use the coordinated federal attack via the anti-tax evasion framework that exists to procure that information.

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Appendix A. Timeline of the Anti-Tax Evasion Measures

1970	Report of Foreign Bank and Financial Account (Bank Secrecy Act)
2000	Qualified Intermediary Program
2003	Limited three month Offshore Voluntary Disclosure initiative
2007	John Doe Summons served on UBS
2009	1st Offshore Voluntary Disclosure Program
2010	Foreign Account Tax Compliance Act
2011	2nd Offshore Voluntary Disclosure Program
2012	3rd (and final) Offshore Voluntary Disclosure Program

Appendix B. Definitions for FATCA Chapter (Chapter 9)

Documentation and Identification definitions:

AML/KYC Procedures: the customer due diligence procedures of a financial institution pursuant to the anti-money laundering or similar requirements to which the financial institution, or branch thereof, is subject. This includes identifying the customer (including the owners of the customer), understanding the nature and purpose of the account, and ongoing monitoring.[1520]

Beneficial Owner: the owner of the income for tax purposes and who beneficially owns that income."[1521] When the person would include the amount paid in their gross income under U.S. tax law then they are the beneficial owners.[1522] Persons who are not considered beneficial owners despite receiving income are working in a capacity such as a nominee, agent or custodian for another person.[1523]

Foreign Entity: any entity that does not fall under the definition of a U.S. Person.[1524]

Substantial U.S. Owner: with respect to any partnership or corporation, any specified U.S. person that owns (directly or indirectly) more than 10% of the stock in the case of the corporation and profits interests or capitals interests in the case of a partnership. In the case of a trust, any specified U.S. person that is treated as an owner of any part

[1520] 26 C.F.R. §1.1471-1 (b)(4).
[1521] 26 U.S.C. §1473(2); *See* also, 26 C.F.R. 1.1441-1 (c)(6)(i).
[1522] 26 C.F.R. 1.1441-1 (c)(6)(i).
[1523] 26 C.F.R. 1.1441-1 (c)(6)(i).
[1524] 26 U.S.C. §1473 (5).

of a trust or a U.S. person who holds (directly or indirectly) more than 10% of the beneficial interests. [1525]

U.S. Account: any financial account that is maintained by an FFI that is held by (owned) one or more U.S. persons or U.S.-owned foreign entities.[1526]

U.S. Person: a citizen or resident of the U.S., a domestic partnership, a domestic corporation, any estate other than a foreign estate, and any trust if a court within the U.S is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust.[1527]

Reporting Definitions:

FATCA Partner Reportable Account: a Financial Account maintained by a Reporting U.S. Financial Institution if: (i) in the case of a Depository Account, the account is held by an individual resident in [FATCA Partner] and more than $10 of interest is paid to such account in any given calendar year; or (ii) in the case of a Financial Account other than a Depository Account, the Account Holder is a resident of [FATCA Partner], including an Entity that certifies that it is resident in [FATCA Partner] for tax purposes, with respect to which U.S. source income that is subject to reporting under chapter 3 of subtitle A or chapter 61 of subtitle F of the U.S. Internal Revenue Code is paid or credited."[1528]

Financial Account: this includes depository accounts, custodial accounts, equity or debt interests and insurance and annuity contracts.[1529]

[1525] 26 U.S.C. §1473 (2).
[1526] 26 C.F.R. §1.1471-5 (a).
[1527] 26 U.S.C. §7701 (a)(30).
[1528] Inter-governmental Agreement Model 1, art. 1 (bb)
[1529]

Recalcitrant Owner: Under the regulations, a recalcitrant owner is an account holder that fails to comply with reasonable requests for the information requested or fails to provide a waiver.[1530]

Reportable Account: A reportable account is one of two types of accounts: a U.S. reportable account or a FATCA Partner Reportable Account.[1531]

Substantial United States: any U.S. person that owns, directly or indirectly more than 10% of the stock or profits of a foreign corporation or a foreign partnership.[1532] In the case of the ownership of a foreign trust, a specified U.S. person is considered an owner of any portion of such a trust under 26 U.S.C. §671-679 and holds directly or indirectly, more than 10 percent of the beneficial interests of the trust.[1533]

U.S. Reportable Account: A U.S. reportable account is a "Financial Account maintained by a Reporting [FATCA Partner] Financial Institution and held by one or more Specified U.S. Persons or by a Non-U.S. Entity with one or more Controlling Persons that is a Specified U.S. Person."[1534]

Withholding Definitions:

Withholding Agent: this is any person in the position of having control, receipt, custody, disposal, or payment of any withholdable payments.[1535]

Withholdable Payment: a U.S.-source payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other FDAP gains, profits and income (FDAP as discussed in Chapter 7 QI).[1536] Also, any

[1530] 26 U.S.C. §1471(d)(6)(A)-(B).
[1531] Inter-govermental Agreement Model 1, art. 1 (aa)
[1532] 26 U.S.C. §1473 (2)(A)(i)-(ii); *See also*, 26 C.F.R. §1.1473-1 (b)(1)(i)-(ii).
[1533] 26 U.S.C. §1473 (2)(A)(iii); *See also*, 26 C.F.R. §1.1473-1 (b)(1)(iii).
[1534] Inter-govermental Agreement Model 1, art. 1 (cc)
[1535] 26 U.S.C. §1473 (4).
[1536] 26 U.S.C. §1473 (1).

gross proceeds from the sale or disposition of any property that can produce interest or dividend U.S.-source payments.[1537]

Definitions for the various intermediaries (these can also apply to the QI Chapter):

FFI: as a foreign entity[1538] that engages in accepting deposits in the ordinary course of banking or similar business, holds financial assets for the account of others that is a substantial part of its business or is in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest in such securities, partnership interests or commodities.[1539] [1540]

Participating FFI: the term participating FFI means an FFI that has agreed to comply with the requirements of an FFI agreement with respect to all branches of the FFI, other than a branch that is a reporting Model 1 FFI or a U.S. branch. The term participating FFI also includes an FFI described in a Model 2 IGA that has agreed to comply with the requirements of an FFI agreement with respect to a branch (a reporting Model 2 FFI), and a QI branch of a U.S. financial institution, unless such branch is a reporting Model 1 FFI.[1541]

Non-Participating FFI: The term nonparticipating FFI means an FFI other than a participating FFI, a deemed-compliant FFI, or an exempt beneficial owner.[1542]

Deemed-Compliant FFI: the term deemed-compliant FFI means an FFI that is treated, pursuant to section 1471(b)(2) and 1.1471-5(f), as meeting the requirements of section 1471(b). This means that as long as the FFI complies with any procedures set out by the Secretary of the Treasury to ensure that the institution does not maintain

[1537] 26 U.S.C. §1473 (1)(A)(i)-(ii); *See also*, 26 C.F.R. §1.1473-1 (a)(1).
[1538] 26 U.S.C. §1471 (d)(4).
[1539] 26 U.S.C. §1471 (d)(5); *See also*, 26 C.F.R. §1.1471-5(d).
[1540] 26 C.F.R. §1.1471-5(d).
[1541] 26 C.F.R. §1.1471-1 (b)(91).
[1542] 26 C.F.R. §1.1471-1 (b)(82).

U.S. accounts. This also applies to institutions that this specific section (26 U.S.C. §1471 (b)(2) does not apply to as determined by the Secretary. The term deemed-compliant FFI also includes a QI branch of a U.S. financial institution that is a reporting Model 1 FFI.[1543] Boiled down, a deemed-compliant institution is one that is determined to already be in compliance based on the way it functions and exists in the financial services framework.[1544] This status can be applied for with the IRS, receives an FFI number and certifies to the IRS every three years that it meets the requirements for deemed compliant status.[1545]

Registered Deemed Compliant FFI: this is an FFI that meets the procedural requirements set out in 26 C.F.R. §1.1471-5(f)(1)(ii).[1546] In order to meet this status, the FFI must register with the IRS and complies with the agreement made between the U.S. and its own government.

Certified Deemed Compliant FFI: this is an FFI that has certified its status to a withholding agent by providing the documentation required in 26 C.F.R. §1.1471-3(d)(5).[1547] The certified deemed-compliant FFI is not required to register with the IRS in contrast to the registered deemed-compliant FFI who does.

NFFE: the term NFFE or non-financial foreign entity means a foreign entity that is not a financial institution (including a territory NFFE). The term also means a foreign entity treated as an NFFE pursuant to a Model 1 IGA or Model 2 IGA.[1548]

[1543] 26 U.S.C. §1472 (2); 26 C.F.R. §1.1471-1 (b)(27); IRS Notice 2011-34 (April 8, 2011).
[1544] Ross K. McGill, U.S. Withholding Tax: Practical Implications of QI and FATCA,
[1545] IRS Notice 2011-34 (April 8, 2011).
[1546] 26 C.F.R. §1.1471-5(f)(1).
[1547] 26 C.F.R. §1.1471-5 (f)(2); *See also*, 26 C.F.R. §1.1471-3(d)(5) (describing the documentation that the Cert. deemed-compliant FFI should give to the withholding agent).
[1548] 26 C.F.R. §1.1471-1 (b)(80).

Appendix C. Alleged Tax Haven Countries & International & U.S. Agreements

	OECD Blacklist	Initial EU Blacklist	Parties to the Convention on Mutual Administrative Assistance in Tax Matters (OECD)	US Tax Treaties	FATCA Agreements	John Doe Summons from 5:05-cv-04167 (N.D. Cal. 2005)
Afghanistan						
Albania			Protocol			
Algeria					x	
Andorra	x	x	Protocol			
Angola					x	
Antigua and Barbuda	x	x			x	x
Argentina			Protocol			
Armenia				x (1987)	x	
Aruba	x		Original Convention & Protocol			x
Austrailia				x (1983 + protocol)	x	
Austria	x			x (1999)	x	
Azerbaijan *				x (1987)	x	
Bahamas	x	x			x	x
Bahrain	x				x	
Bangladesh				x (2007)		
Barbados		x			x	x
Belarus				x (1987)	x	
Belgium	x			x (2008)	x	
Belize	x	x				x
Benin						
Bhutan						
Bolivia						
Bosnia and Herzegovina						
Botswana						
Brazil					x	
Brunei	x	x				

Bulgaria				x (2009)	x	
Burkina Faso						
Burma						
Burundi						
Cambodia						
Cameroon						
Canada				x (1985 + protocol)	x	
Cabo Verde					x	
Central African Republic						
Chad						
Chile	x				x	
China				x (1987)	x	
Colombia					x	
Comoros						
Congo, Democratic Republic of						
Congo, Republic of	x					
Cook Islands	x	x				x
Costa Rica	x				x	x
Code d'Ivoire						
Croatia					x	
Cuba						
Curacao					x	
Cyprus	x				x	x
Czechia (Czech Republic)				x (1994)	x	
Denmark				x (2001 + 1 protocol)	x	
Djibouti						
Dominica	x				x (agreement in substance)	x
Dominican Republic					x	
East Timor						

Ecuador						
Egypt				x (1982)		
El Salvador						
Equatorial Guinea						
Eritrea						
Estonia				x (2000)	x	
Ethiopia						
Fiji						
Finland				x (1991 + 1 protocol)	x	
France				x (1996 + 2 protocols)	x	
Gabon						
Gambia						
Georgia				x (1987)	x	
Germany				x (1990 + 1 protocol)	x	
Ghana						
Greece					x	
Grenada	x	x			x	x
Guatemala	x					
Guinea						
Guinea-Bissau						
Guyana					x	
Haiti					x (agreement in substance)	
Holy See					x	
Honduras					x	
Hong Kong		x			x	x
Hungary				x (1980)	x	
Iceland				x (2009)	x	
India				x (1991)	x	
Indonesia				x (1990)	x	

Iran						
Iraq					x	
Ireland				x (1998 + amendment)	x	
Israel				x (1995)	x	
Italy				x (2010)	x	
Jamaica				x (1982)	x	
Japan				x (2005)	x	
Jordan						
Kazakhstan *				x (1987)	x	
Kenya						
Kiribati						
Korea (North)						
Korea (South)				x (1980)	x	
Kosovo					x	
Kuwait					x	
Kyrgyzstan *				x (1987)		
Laos						
Latvia				x (2000)	x	x
Lebanon						
Lesotho						
Liberia	x	x				
Libya						
Lichtenstein	x	x			x	x
Lithuania				x (2000)	x	
Luxembourg	x			x (2001)	x	x
Macau					x	
Macedonia						
Madagascar						
malawi						
Malaysia	x				x	
Maldives		x				

Malta	x			x (2011)	x	x
Marshall Islands	x	x				
Mauritania					x	
Mauritius	x	x				
Mexico				x (1994 + 2 protocols)	x	
Micronesia						
Moldova				x (1987)	x	
Monaco	x	x				
mongolia						
Montenegro					x	
Morocco				x (1981)		
Mozambique						
Namibia						
Nauru	x	x				x
Nepal						
Netherlands				x (1994 + 1 protocol)	x	
New Zealand				x (1984 + 1 protocol)	x	
Nicaragua					x	
niger						
Niue	x	x			x	
Nigeria						
Norway				x (1971 + 1 protocol)	x	
Oman						
Pakistan				x (1960)		
Palau						
Palestinian Territories						
Panama	x	x			x	x
Papua New Guinea						

Paraguay						x	
Peru						x	
Philippines	x			x	(1983)	x	
Poland				x	(1974)		
Portugal				x	(1996)	x	
Qatar						x	
Romania				x	(1974)	x	
Russia				x	(1994)		
Rwanda							
Saint Kitts & Nevis	x	x				x	x
Saint Lucia	x					x	x
Saint Vincent & the Grenadines	x	x				x	x
Samoa	x						x
San Marino	x					x	
Sao Tome & Principe							
Saudi Arabia						x	
Senegal							
Serbia						x	
Seychelles	x	x				x	
Sierra Leone							
Singapore	x					x	x
Saint Maarten							
Slovakia				x	(1993)	x	
Slovenia				x	(2002)	x	
Solomon Islands							
Somalia							
South Africa				x	(1998)	x	
Spain				x	(1991)	x	
Sri Lanka				x	(2004)		
Sudan							
Suriname							

Swaziland						
Sweden				x (1996 + 1 protocol)	x	
Switzerland	x			x (1998)	x	x
Syria						
Taiwan					x	
Tajikistan *				x (1987)		
Tanzania						
Thailand				x (1998)	x	
Timor-Leste						
Togo						
Tonga						
Trinidad & Tobago				x (1970)	x	
Tunisia				x (1990)	x	
Turkey				x (1998)	x	
Turkmenistan *				x (1987)	x	
Tuvalu						
Uganda						
Ukraine				x (2001)	x	
United Arab Emirates					x	
United Kingdom				x (2004)	x	
Uruguay						
Uzbekistan *				x (1987)	x	
Vanuatu	x	x				x
Venezuela				x (2000)		
Vietnam					x	
Yemen						
Zambia						
Zimbabwe						

Territories

British Virgin Islands	x	x			x	x
US Virgin Islands	x	x				
Jersey	x				x	x
Isle of Man	x				x	x
Bermuda	x	x			x	x
Guernsey/Sark/Alderney	x	x				x
Cayman Islands		x			x	x
Turks & Caicos Islands	x	x			x	x
Gibraltar	x				x	x
Anguilla	x	x			x	x
Montserrat	x	x			x	
Greenland					x	
Netherland Antilles						x
Guam						
American Samoa						
* Countries in the Commonwealth of Independent States						

ISSN (online): 2246-1256
ISBN (online): 978-87-7210-457-7

AALBORG UNIVERSITY PRESS